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cutting through complexity

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Metallurgical Coal

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Sector uncertainty, with strengthening demand

Headwinds for the industry, both market and regulatory have continued over the past few months. As a result, companies are re-evaluating the economics of their projects based upon current pricing curves. Early activity in this regard has resulted in some asset write downs announced with 2012 calendar year end results. Met coal producers will be looking at their cost structures, as well as long-term investments, with an eye on the next pricing uptick.

The year also presents some macro-economic uncertainties that will affect multiple sectors. Industry participants wonder whether the EU economic situation will be able to stabilize long term, or will that be a rollercoaster we all watch and ride? Or, will the executive and legislative branches in the US be able to make long-term fundamental changes to the spending and revenue models?

As we enter 2013, both India and China continue to be key demand drivers for this commodity. Over time, the infrastructure development growth in other countries will also drive demand and pricing. The velocity of demand will be the key factor that producers will be watching, as it impacts their investments and development of both current and future assets.

Commodity outlook

With 1Q13 contract prices settling at US\$165/t – US\$5/t below the 4Q12 levels, global mining experts/analysts expect the underperformance of met coal in 2012 to continue in 2013. However, an expected recovery in global industrial production should lead to stronger steel production 2013 onwards. This, in turn, is expected to increase the demand for met coal and should offer some support to met coal prices by 2014.

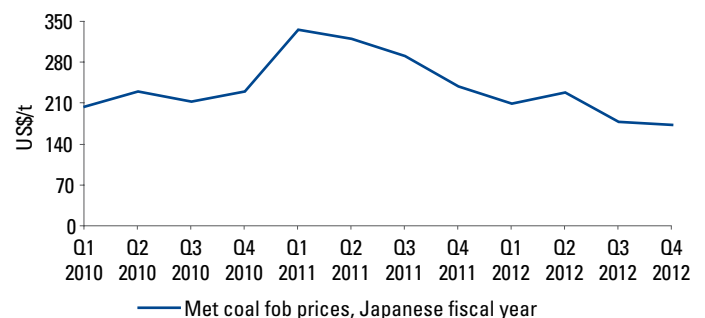
While supply was the key governing factor of met coal market dynamics during 2011 and 2012; in 2013, demand is expected



to be the guiding force. Though there was destocking of steel by key consumers such as China in late 2012, the situation is expected to improve in the coming months, driven by an expected increase in steel demand. Additionally, with an ongoing lack of scrap availability, steel consumption growth is set to steer the met coal demand during the subsequent years leading to price recovery in the sea-borne met coal markets.

On the pricing front, the December 2012 quarter ended on a further lower note. The price of the high-quality met coal settled at US\$170/t, 28 percent lower on y-o-y basis and 3 percent lower on q-o-q basis.

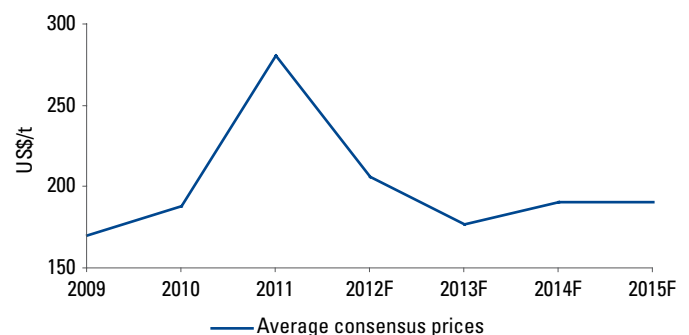
Figure 1: Met coal prices (1Q10–4Q12)



Source: Nippon Steel Corporation presentation, Metal Bulletin, Bloomberg

The latest average consensus contract price estimate for 2012 is US\$210/t¹, down 24 percent from the 2011 average of US\$289/t. However, the consensus price estimates indicate that the prices of met coal are expected to increase post 2013, primarily driven by an increased demand due to increased steel production.

Figure 2: Met coal prices (2009 – 15F)

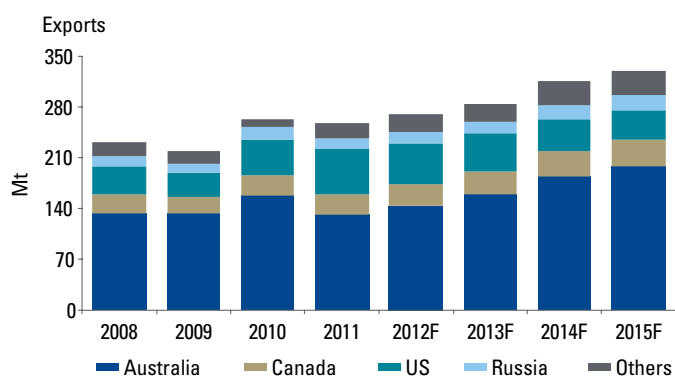


Source: BMO capital markets, Macquarie Research, Deutsche Bank, Credit Suisse, KPMG analysis

¹ Consensus price is the average of price estimates by BMO capital markets, Macquarie Research, Deutsche Bank and Credit Suisse

Supply and demand

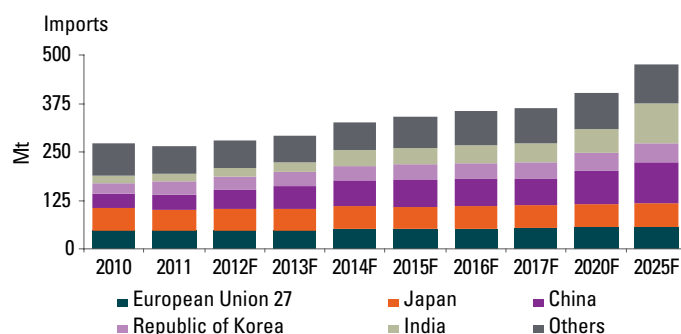
Figure 3: Global met coal exports (2008–15F)



Source: World Coal Association, BREE, KPMG analysis

- Australian met coal exports for 2012 are forecasted to increase 9 percent y-o-y to 145Mt (lower than the previous estimate of 151Mt). In 2013, the met coal exports are expected to grow by 11 percent, to 161Mt, driven by increased production from BHP Billiton Mitsubishi Alliance-owned mines in Queensland, and start up of a number of mines including Peabody Energy's Burton mine and Anglo Coal's Grosvenor underground mines.²
- The met coal export from the US is forecast to decrease 9 percent y-o-y in 2012 to 57Mt and further 5 percent y-o-y in 2013 to 54Mt. Exports from Canada are expected to increase 7 percent y-o-y to reach 30Mt in 2012. They are expected to further increase 3 percent y-o-y to reach 31Mt by 2013.³
- Mozambique is expected to become a key met coal exporter in the medium term. This is expected to be driven by the ramp up of the Moatize thermal and coking coal mine operated by Vale. The mine shipped 2Mt in 2012, while the target for 2013 is 4.5Mt, of which about 75 percent is expected to be met coal. This ramp up is expected to continue until a final target of 22Mtpa is achieved.⁴
- In the medium term, lack of growth in supply is expected to be a key driver in the hard met coal industry. Though Australia and Mozambique have showed growth, tonnages from the US have remained stagnant to falling. With Mongolia not likely to grow in 2013, new high-quality hard coking coal projects are expected to remain scarce.⁵

Figure 4: Global imports of met coal (2010–25F)



Source: World Coal Association, BREE, KPMG analysis

According to a report by BREE, the trade volume in the met coal market increased by 5 percent y-o-y to reach 272Mtdue to lower demand. In 2013, world trade is forecast to increase by a further 5 percent to 286Mt supported by strong import growth in China and India.⁶

- China's met coal imports are expected to increase by 29 percent to 49Mt in 2012. China's imports are expected to further increase by 18 percent in 2013 to total 58Mt, driven by increased demand from Chinese steel producers due to restocking of steel.⁷
- India has one of the lowest per capita steel consumption in the world at only 57kg, compared to the global average of 215kg. The demand for steel in the country is expected to grow in parallel to the expected GDP growth. However, the growth in domestic met coal production is not expected to catch up with the increasing demand. As a result, India is expected to be a major contributor to higher world met coal import demand in the coming years. The country's imports are forecast to increase 16 percent y-o-y to 22Mt in 2012. Further, they are expected to increase 18 percent y-o-y to 26Mt in 2013.⁸
- Imports by the European Union are expected to remain flat in 2012 and 2013, compared to 2011, at around 46Mt. This restricted growth in 2012 and 2013 is consistent with unchanged steel production forecast for the European Union during these years.⁹

² "Resources and Energy Quarterly, December Quarter 2012", Australian Government – Bureau of Resources and Energy Economics, December 2012, p27

³ "Resources and Energy Quarterly, December Quarter 2012", Australian Government – Bureau of Resources and Energy Economics, December 2012, p27

⁴ Morgan Stanley – Metals & Mining call – Profit Taking Ahead of 4Q Results on China CPI Data, 13 January 2013, via Thomson Research/Investext, accessed 28 February 2013; "Brazilian group Vale increases production at the Moatize coal mine in Mozambique", *Macauhub.com*, 29 January 2013

⁵ Macquarie Commodities Research – Commodities compendium: Inventories the differentiator in 2013, 17 January 2013, via Thomson Research/Investext, accessed 12 February 2013

⁶ "Resources and Energy Quarterly, December Quarter 2012", Australian Government – Bureau of Resources and Energy Economics, December 2012, p27

⁷ Mario Parker "Coking Coal May Rebound as China Restocks Steel, Barclays Says", *Bloomberg*, 4 January 2013; Resources and Energy Quarterly, December Quarter 2012", Australian Government – Bureau of Resources and Energy Economics, December 2012, p27

⁸ [Coal and steel statistics], [World Coal Association], [http://www.worldcoal.org/], accessed 28 January 2013; "Resources and Energy Quarterly, December Quarter 2012", Australian Government – Bureau of Resources and Energy Economics, December 2012, p27

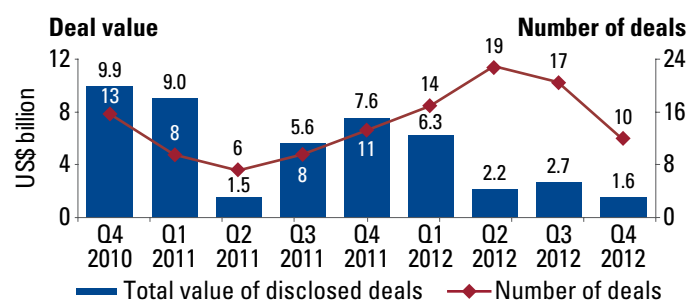
⁹ "Resources and Energy Quarterly, December Quarter 2012", Australian Government – Bureau of Resources and Energy Economics, December 2012, p27

Key developments

Ownership changes¹⁰

During 4Q12, the total valuation of major deals announced in the coal industry was US\$1.57 billion, down from US\$2.68 billion in 3Q12, representing a q-o-q decrease of 41 percent. The number of deals announced during 4Q12 fell to 10, against 17 announced in 3Q12. Out of the 10 deals announced in 4Q12, three were successfully closed.

Figure 5: Value of major deals announced in the coal industry



Source: Mergermarket Factiva, KPMG analysis

Table 1: Top met coal deals announced in 4Q12

Date announced	Target (Nation)	Acquirer (Nation)	Status	Value of transaction (US\$ million)	Stake (%)
20-Dec-12	Bengkulu coal project (Indonesia)	Killara resources (Australia)	In progress	2.8	85
5-Dec-12	Decker Coal Company in southern Montana and the Black Butte Coal Company in Wyoming (USA)	Ambre Energy Limited (Australia)	Closed	59.9	50
4-Dec-12	Asia Coal Ltd. (China)	Sharp Victory Holdings Limited (British virgin islands)	In progress	50.0	75
29-Oct-12	Endocoal Limited (Australia)	U&D Mining Industry (Australia) Pty Ltd. (Australia)	In progress	74.6	100
25-Oct-12	Union Energy (LuoZhou and LaShu Mines)	L & L Energy Inc. (US)	In progress	37.1	95
19-Oct-12	Galway Resources Ltd. (Canada)	AUX Acquisition 2 S.A.R.L. (Canada)	In progress	NA	NA
11-Oct-12	Pine Branch Coal Sales Inc. (USA)	Blackhawk Mining LLC (USA)	In progress	NA	NA
4-Oct-12	Raspidskaya OAO (Russia)	EVRAZ Plc (USA)	Closed	1,214.00	41
3-Oct-12	AK Steel (USA)	Solar Fuel company	Closed	36	100
1-Oct-12	Coal of Africa Limited (Australia)	Beijing Haohua Energy Resource Co Ltd (China)	In progress	100	24

Source: Mergermarket, Capital IQ, Factiva, Company Reports

Regulatory updates

The regulations introduced during 4Q12 were mostly aimed at enhancing and streamlining domestic coal mining operations. They are anticipated to help in the optimal utilization of the available resources.

Table 2: List of recent regulations in the coking coal industry

Country/ Region	Regulation/Topic	Description
Mozambique	Capital gains tax increased ¹¹	<ul style="list-style-type: none"> The country has imposed a 32 percent capital gains tax on the future sales of assets owned by foreign companies in Mozambique. The tax will be effective from January, 2013, and is inapplicable retroactively to previously closed deals.
India	Amendment to the coal regulatory authority bill ¹²	<ul style="list-style-type: none"> The coal ministry has amended the coal regulatory authority bill and empowered the proposed coal regulatory authority to have a decisive say in fixing prices of coal.
US	Extension of state aid to North Dakota coal plant backers ¹³	<ul style="list-style-type: none"> The North Dakota Industrial Commission has provided the backers of a proposed coal-to-liquid fuel plant in western North Dakota a fifth extension of state aid for studying the project. The state Industrial Commission committed up to US\$10 million as state aid in 2007 from coal tax collections to determine the project's potential.

¹⁰ Mergermarket database, Capital IQ database, accessed December 2012

¹¹ Agnieszka Flak and Pascal Fletcher "UPDATE 1-Mozambique to tax capital gains at fixed rate of 32 pct * Amended capital gains tax law becomes effective Jan 1", *Reuters*, 17 December 2012

¹² "Coal regulatory authority to be given powers for coal pricing", *Indianpowermarket.com*, 26 December 2012

¹³ "North Dakota coal plant backers get extension of state aid", *WDay news*, 15 December 2012

Project updates

Table 3: Cross-section of major Metallurgical Coal projects¹

Project	Country	Owners/Operators	Capex (US\$ million)	Potential start year	Full capacity (Mtpa)	Progress and updates
Appin Area 9	Australia	BHP Billiton	845	2016	3.5	The project is progressing as per schedule and within the prescribed budget. The project is 30 percent complete.
Belvedere underground	Australia	Aquila/Vale	2,000*	NA	10	'Significant project' declaration repealed by Coordinator-General of the Department of State Development, Infrastructure and planning, Queensland government.
Broadmeadow (mine life extension)	Australia	BHP Billiton Mitsubishi Alliance (BMA)	900	2013	0.4	The project is progressing as per schedule and within the prescribed budget. The project is 95 percent complete.
Caval Ridge	Australia	BHP Billiton Mitsubishi Alliance (BMA)	3,740 ¹	2014	5.5	The project is progressing as per schedule and within the prescribed budget. The project is 52 percent complete.
Daunia	Australia	BHP Billiton Mitsubishi Alliance (BMA)	1,600	2013	4.5	The project is progressing as per schedule and within the prescribed budget. The project is 82 percent complete.
Eagle Downs (Peak Downs East underground)	Australia	Aquila Resources/Vale	875	2016	4	Aquila resources is seeking a co-investor for the project in order to finance its development. Also, Vale S.A. approved the 2013 investment budget of US\$5M for the development of a new underground mine at Eagle Downs.
Hay point stage three expansion	Australia	BHP Billiton Mitsubishi Alliance (BMA)	2,500 ¹	2014	Increased port capacity by 11Mtpa	The project is progressing as per schedule and within the prescribed budget. The project is 57 percent complete.
Benga coal mine	Mozambique	Rio Tinto coal Mozambique (RTCM)	NA	2012	NA	The mine moved to commercial production during 3Q12. Production at the mine continued to ramp up.
Moatize II	Mozambique	Vale	2,068	2014	7.7	New pit and duplication of the Moatize coal handling and preparation plant, as well as all related infrastructure in progress.

* AU\$

¹ The list is not exhaustive and contains only a limited number of projects
Source: BREE, Company Reports

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