STEAMING COAL SET TO OUT-PERFORM COKING COAL IN LONG TERM

DESPITE SHORT TERM OVERSUPPLY

by

Ian Story

Partner, Meares & Philips

* Price differentials will continue to narrrow between steaming coal and hard coking coal as new technologies enable steaming coal to be gradually substituted for coking coal.
* Nippon Steel, Sumitomo and other Japanese steel mills are developing new technologies including pulverised coal injection (PCI) which will reduce coking coal usage by at least 20 per cent through the substitution of steaming coal which currently sells for significantly lower prices.
* A series of economic factors are gradually mitigating in favour of steaming coal. Rotterdam steaming coal spot prices have risen by $4 per tonne in the last month, South Africa is short until July, Poland is sold out, and the USA is offering steaming coal at US$44 per tonne.
* While Utah has agreed to a $3 cut on its low quality Blackwater mine, it is highly probable that the three other Utah contracts for Peak Downs, Goonyella and Saraji, expiring later in 1984 will all settle at US$54, higher than the new industry average price of US$52.50 and $3.00 per tonne higher than prices agreed to earlier this year by US and South African producers (US$51).

Coal Price Forecasts

	1983(A)	1984(E)	1985(E)	1986(E)	1987(E)
Hard Coking Coal ($US)	$54.00	$52.50	$57.00	$64.00	$74.00
Soft Coking Coal ($US)	$45.25	$45.25	$50.00	$56.00	$64.00
Steaming Coal ($A)	$43.00	$43.00	$47.00	$54.00	$62.00

MODEST IMPROVEMENT IN STEAMING COAL OUTLOOK

Events in recent weeks have resulted in a slightly more optimistic outlook for the Australian Coal Industry. World steaming coal demand will increase by 4 per cent p.a. until the end of the century.

- The escalation of hostilities in the Middle East War.
- Reduced wages growth rates in Japan.
- Japanese steel production increasing to a forecasted 104 million tonnes next year.
- The British coal strike could remove significant quantities of steaming coal from export markets if it continues.
- South Africa's major coal loading port at Richards Bay has suffered cyclone damage, resulting in shipping delays and 800,000 tonnes of coal sliding into the ocean.
- The longer term impact of the BHP takeover of Utah will have a positive influence on prices as the export tonnages under BHP's control increase dramatically.

In 1983 Japanese coking coal imports fell to 60 million tonnes, compared with 65 million tonnes in 1982.

At the same time, Japanese steaming coal imports increased to around 14.5 million tonnes, up from 13.6 million tonnes in 1982. Steaming coal continues to account for an ever increasing share of Japanese coal imports.

MAIN DANGER IS SOUTH AFRICA

South Africa is still the only country which can land coal in Japan more cheaply than Australian producers. This fact is simply due to the different philosophical approach taken by the South African Government, in that it does not demand artificially high rail freights, royalties and loading charges from its local export industry. The South African Government simply taxes the coal companies' profits at the normal rate of corporate income tax.

Despite all the criticisms which have been heaped upon our local industry, it remains a fundamental fact that the total direct costs of producing coal in Australia are identical with the costs of production in South Africa, Canada or the USA.

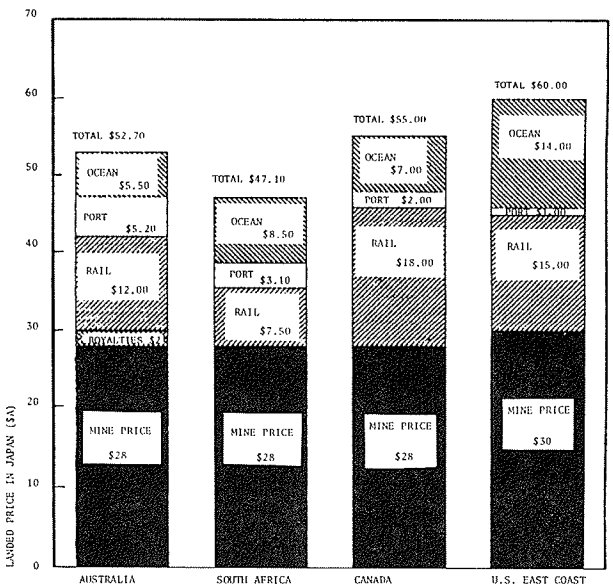
Australia is an efficient producer, and our mines are highly mechanised, with high productivity rates, typically around 30 tonnes of coal per manshift from the new breed of open cut mines.

Although Australian wage rates are around three times as high as South Africa's, our productivity rates are also three times greater, so that the cost of getting the coal to the mine-head is identical in Australia and South Africa.

TABLE 1

Australia's Competitiveness is Determined by the level of State Government Charges

Costs of Landing Coal in Japan from Major Supplying Countries



NSW RAIL CHARGES ARE TOO HIGH

Australia's competitiveness in landing coal in Japan is not determined by the costs of mining, but rather the costs of rail freights, port charges and ocean freights.

NSW rail charges for coal are the highest in the world if the very short local rail-haul distances are taken into account. Average NSW rail charges are around 8¢ per tonne/km, compared with 6¢ in Queensland, 3¢ in the USA, 1.6¢ in Canada and 1.5¢ in South Africa.

TABLE 2

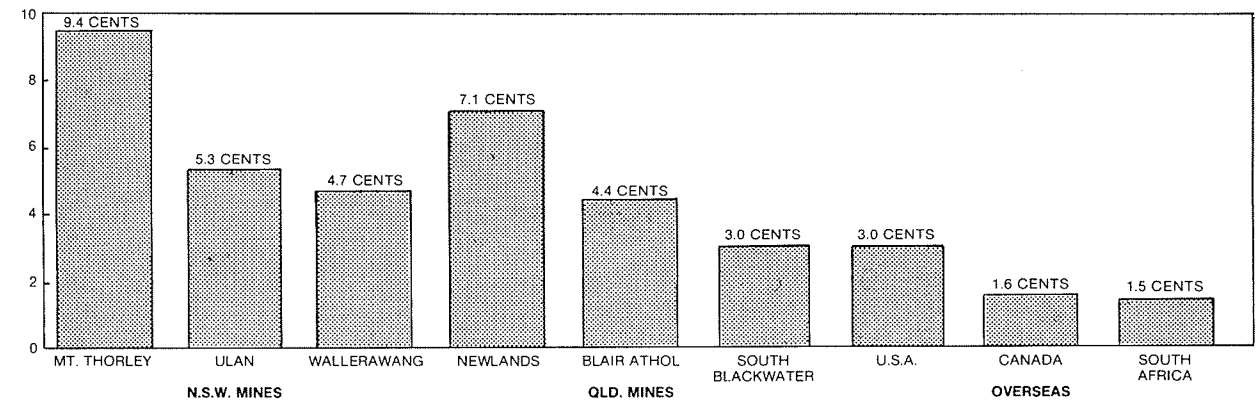
NSW Rail & Port Charges the Highest in the World Four Times the Rail Charges in South Africa and Canada

1983 Costs in Australian Dollars per Metric Tonne

Country	Rail Freight		Port Charges		Total
Mine and Port	Freight Per Tonne	Distance to Port	Freight Per Tonne Per Km.	Loading Charges Per Tonne	Rail & Port Charges Per Tonne
Australia					
N.S.W.					
Wallerawang (Port Kembla)	$12.02	257 kms	4.7¢	$5.22	$17.24
Mt. Thorley	$ 7.99	85 kms	9.4¢	$5.21	$13.20
Ulan (N'Castle)	$15.30	279 kms	5.3¢	$5.21	$20.51
Weighted Average	$ 8.60	105 kms	8.2¢	$5.22	$13.82
Queensland					
S. Blackwater to Auchland Pt.	$10.05	343 kms	2.93¢	$2.50	$12.55
Blair Athol to Hay Pt. 2	$13.11	295 kms	4.44¢	$3.40	$14.51
Newlands to Abbot Pt.	$13.25	187 kms	7.08¢	$2.00	$15.25
South Africa (Richards Bay)	$ 7.24	500 kms	1.45¢	$3.14	$10.38
Canada Fording to Roberts Bank	$18.68	1175 kms.	1.55¢	$1.74	$20.42
U.S.A. East Coast to Hampton Roads	$18.90	640 kms	2.95¢	$0.70	$19.60

TABLE 3

Rail Freights Four Times South Africa and Canada and Double U.S.A. Rail Costs



WHY ARE NSW RAIL CHARGES SO HIGH?

Rail transportation costs are primarily dependent on capital costs rather than wages.

The South African railways make use of much larger average rail hauls and use an average of around 100 wagons per train compared with 22 in NSW.

Rail Systems in NSW and South Africa

	NSW	South Africa
Distance to Port	105 kms	500 kms
Freight per Tonne	$8.60	$7.24
No. of Wagons	22	100
No. of Locomotives	2	5
Average load per haul	1,628 tonnes	8,400 tonnes

It takes five rail hauls in NSW to transport the average South African shipment. These five NSW hauls require approximately fifty more men than would be required to haul the same load in South Africa.

Another factor which tends to make NSW rail transport less efficient is the fact that much coal is loaded in small tonnages by means of front-end loaders rather than more efficient rail loops costing some $5M-$6M to install. At the present time the rail charges for each method are similar, leaving little incentive for the coal producers to spend the additional capital.

Recently the Federal Government's National Energy Advisory Committee published a booklet on "The Transportation of Export Coal". The NEAC stated that "These (Rail) charges appear to be on average at least three times as high as those applicable in Canada, USA and South Africa".

NSW SHARE OF NEW COAL MARKETS DECREASING

Despite the fact that NSW has been blessed with some of the world's best coal mines, the coal export industry is currently in serious trouble, and many higher cost underground mines are on the verge of collapse due to excessive State Government taxes and charges.

The NSW producers share of new markets has been steadily falling from 55 per cent in 1970 to around 20 per cent today. In contrast, South Africa has been able to capture an increased share of new markets, rising from zero in 1970, to approximately 40 per cent today.

Why have South African coal producers been so successful?

The answer lies in the attitude of the South African Government, who encourage the domestically based coal industry to penetrate export markets and thereby increase economic activity at home and provide additional jobs. South African producers pay the normal company income tax but are not saddled with any additional imposts.

Estimated World Production Capacity for Seaborne Coal

(MTPA)	1983	1990	2000
USA	160	185	185
Canada	32	35	38
South Africa	34	41	48
Australia	89	125	125
Columbia	—	15	25
China	5	10	10
Others	30	30	30
Total	350	441	461

STEAMING COAL: A GROWING MARKET SUBJECTED TO TEMPORARY SUPPLY

Unfortunately, the prospects facing Australian steaming coal producers are not quite so attractive. This is somewhat ironic because in the longer term the prospects for the world steaming coal industry are much brighter than for coking coal which is tied to stagnating world demand for steel.

Longer term projections indicate steaming coal demand growing at 4 per cent p.a. while coking coal demand is projected to grow at only 1 per cent p.a. for the rest of the decade.

The current demise of the world steaming coal industry can be traced back to 1980 when demand growth was running closer to 10 per cent p.a. and a number of new operators were attracted into what promised to be one of the world's most lucrative and rapidly growing industries.

In Australia, these new steaming coal mines included Newlands, Blair Athol, Saxonvale, Drayton, Oaky Creek, Warkworth and Ulan. At the same time other such new mines were committed overseas, with the net result that there will now be an estimated 20 million tonnes per annum overcapacity by 1985.

As a result the world steaming coal industry is now a victim of the classical demise of too many producers chasing too few buyers and it is now becoming apparent that the classical outcome is all but inescapable — a reduction in price.

STEAM COAL PRICES WILL BE DETERMINED BY NEW LOW COST PRODUCERS

The problems of the world steaming coal have been compounded further by the unanticipated discovery of new low cost deposits in Columbia and China.

Consumers the world over demand the lowest cost product. After all, that is the reason that Australia was jettisoned into the industry after the third oil price hike in 1979.

We are now faced with the invideous task of closing some of the older and higher cost mines despite protestations from the trade union movement.

The major risk facing the coal mining industry is that new coal mines are developed at great capital cost to cover a 30 year life but rapidly changing world events make it impossible to predict what is likely to happen for more than five years ahead. In other words, demand is unpredictable for the remaining five-sixths of the economic life of the mine.

One fundamental and inescapable truism which emerged from the 1984 Australian Coal Conference at Surfers Paradise is that coal prices are determined by the cheapest marginal producer and that there is no effective limit to world coal resources.

PRESSURE ON AUSTRALIAN PRODUCERS TO REDUCE PRODUCTION COSTS

The future of the Australian Coal Industry depends entirely on its ability to offer security of supply and to offer price competitiveness.

A new mood of qualified optimism regarding Australia's future coal industry prospects has emerged from the Surfers Paradise 1984 Australian Coal Conference.

Confidence in the future of coal has been severely shaken over the last two years by the actions of governments, unions and Japanese purchasers alike. As a result the Australian Coal Industry developed a depression mentality as Japanese steel production has slipped to the 100 million tonnes benchmark and steaming coal shipments were cut to 60 per cent of contracts.

While coking coal producers are gaining confidence in their ability to stave off any price cut below last year's level of US$54 per tonne, the outlook is not quite so bright for steaming coal producers in the short term.

AUSTRALIAN CAPACITY 50 PER CENT GREATER THAN REQUIRED

The capacity of the Australian Coal Industry is equal to 150 per cent of current sales. Total production capacity is estimated at 136 MTPA compared with 1983 sales of just 92 million tonnes.

On the export side alone there is 37 per cent idle capacity. Total export capacity is 95 MTPA compared with 1983 sales of 60 million tonnes.

More than a third of the total Australian capacity has been completed in the last five years i.e. 48 MTPA of a national total of 136 MTPA. The worst hit areas are the NSW Hunter Valley and the Queensland Bowen Basin.

NEW COLUMBIAN MINE THREATENS FUTURE STEAM COAL MARKET

The world steaming coal outlook is currently clouded by a massive new mine being planned by Exxon in Columbia, South America.

Exxon committed itself to the massive 3 billion dollar, 15 MTPA Cerrejon Project in Columbia on the back of optimistic demand projections from more salubrious times. Exxon has entered a 50/50 joint venture with the Columbian Government to develop South America's largest coal mine.

The Cerrejon Project entails the construction of a dedicated railway and port at Puerto Bolivar. Exxon will be looking to export 1 million tonnes in 1985, 5 million tonnes in 1986 and 15 MTPA thereafter. Exxon plans to sell approximately 10 MTPA into European markets and the remaining 5 MTPA into US Gulf markets.

This single massive new mine will have a depressing impact on world spot market prices which are already under great pressure at around US$30-35 per tonne.

Exxon believes that the mine is so low cost that it will be able to show a profit at any price above US$30 per tonne, thus ensuring that European spot markets will remain extremely competitive in the future.

The net impact of new mines commencing in Third World countries such as Columbia will be to make South Africa even more aggressive and to direct South African exports towards the S.E. Asian and Japanese markets. The future for Australian coal exporters will be ensured as long as they equip themselves so as to be able to compete in an increasingly competitive and cut throat world market. Early indications are that mining costs are already being rationalised so as to enable the Australian industry to capitalise on its many natural advantages.