THE U.S. COAL SUPPLY/DEMAND EQUATION AND HOW IT WILL IMPACT EXPORTS

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September 26, 2001

Good morning. It is, as always, a pleasure for me to be in Brazil. CONSOL has been a supplier of metallurgical coal to the Brazilian steel industry for over 40 years, and 2001 marks the 16th consecutive year I have represented my company in this market. I like the people. I like the music. I like the food. And I love the fact that I no longer have to pay for coffee with a denominated bill that ends in 8 zeros!

Much has changed since my first visit here over a decade and a half ago. In 1985, the Brazilian Steel Mills were government entities. Today they have been privatized. In 1985, a company called Siderbras was responsible for purchasing coal for all the mills. Today, even though there is an element of collaboration, each mill makes its own coal buying decisions. In 1985, the BSM used 1.1 million metric tons per year of domestic coal and 7.4 million metric tons per year was imported. Today all coal is imported...nearly 13.5 million metric tons per year.

On the other hand, some things have not changed. Having Chico Buarque as an agent to assist CONSOL in the sale of its U.S. coal in Brazil is one of them. Those of you who have worked with Chico know two things about him. He is exceptionally competent, and he knows more jokes than any other person on the face of the planet.

Thus it is that I have elected to begin my presentation this morning with a story I first heard from Chico.

"GORILLA IN APPLE TREE" STORY.

A good story. And, I hope you will agree, an equally good analogy to follow it.

The U.S. coal industry is the apple tree. For years we coal miners have been selling the production from that tree (our coal) to both domestic and export customers. Then, almost overnight, the U.S. power utility industry transformed itself into a gorilla. It has climbed to the top of our apple tree and started eating with a voracious, insatiable appetite. It wants every ton of coal it can get its hands on.

Now the question is, "What should we...the U.S. coal mining industry...the ones who own the apple tree...what should we do about it?" Do we let the gorilla eat as much as he wants, including a lot of metallurgical coal which he can digest as easily as any other type of apple? Or do we say, "Sorry, King Kong", and work toward maintaining a diversified market which includes export customers? On one hand, the gorilla is paying top dollar for what he eats. He's also beginning to discuss entry of longer-term contracts for our production. On the other hand, there is value to sales diversity. Common sense says, "Don't put all your eggs, or apples, in one basket".

No one is taking the decision-making process lightly. A lot of information in being collected and analyzed. Some coal suppliers have decided what they will do. Others are still trying to decide. One thing is certain, however. Not all U.S. mining companies will come to the same conclusion because our corporate strategies and objectives are often as different as the coals we produce. Because this is the case, I can not share with you one, official, industry-wide position on whether traditional quantities of U.S. coal will be available to overseas buyers in 2002 and beyond.

What I can do is threefold:

First, I can summarize the facts being considered by the U.S. coal producing community.

Second, I can share some conclusions that CONSOL has drawn after assessing the facts.

Third, I can suggest a course of action coal buyers can take to help keep U.S. coal in the international Market place.

Let us begin with facts as they pertain to coal demand in the United States.

The single largest buyer of U.S. coal is our electric power generation industry. It consumed about 90% of all U.S. coal used domestically in calendar year 2000. Total annual tonnage burned by these utilities has grown consistently since 1990. In 1999, coal provided 50.8% of the net electric generation. It grew to 51.8% in 2000 and is expected to grow again in 2001.

There are basically 2 reasons why coal use by power companies will increase again in 2001.

1) Demand for electricity is anticipated to increase by 2% this year...not bad when one considers the economic slow down we are currently experiencing. For comparison purposes, electricity demand in the U.S. grew 4.9% in 2000, 1.6% in 1999 and 2.5% in 1998.

2) The percent of coal fired capacity utilization at power companies is expected to rise. From 1990 to 2000 the utilization factor had already grown from 59% to 74%. In theory, it can ultimately go as high as 85% to 90%. Each additional percentage point of capacity utilization will add roughly 16.5 million short tons of annual coal demand. Upon reaching an 87.5% capacity factor (half way between 85% and 90%), coal use will have increased by 26% or 223 million short tons annually. An extrapolation of data from the June 2001 coal report published by Merrill Lynch indicates this could occur by 2005.

Incidentally, should anyone believe this growing U.S. demand for electricity – and thus coal – is short lived, take note of Secretary of Energy Spencer Abraham's observation in his 2001 National Report on America's Energy Crisis. He estimated the United States would need to construct approximately 1,300 new power generating facilities over the next 20 years in order to satisfy demand for electricity. For those of you without calculators, that is one new plant every 5.6 days for 2 decades! Construction of more than 40 new coal fired units had already been announced between the end of 2000 and June 2001.

Now some facts about coal supply

The market for coal was terrible as we approached the end of the 20th century. The U.S. coal industry responded by mining fewer tons in 1999 than in 1998. Production in 2000 was then below 1999. The 2.1% decrease in 2000 marked the first time in 40 years that the annual amount of U.S. coal mined went down twice in a row.

In 2001, however, we expect production to improve compared to last year. The question is, "By how much?". Through May of 2001, the U.S. Energy Information Administration indicated a year to date production increase of 9.4%. They revised the June year to date number down to 6.7%. In CONSOL's opinion, the final annual increase for 2001 is likely to be lower still. Why? Because barriers to market reentry are higher than ever for those who dropped out when times were tough. Consider the following:

1) Mining regulatory requirements are being debated in our court system. Until we have some definitive answers, we will continue experiencing delays in getting new mine permits.

2) The cost of obtaining reclamation bonds is substantially higher than in the past. Fewer companies can afford the cost and loss of cash flow.

3) The supply of skilled labor, particularly underground miners, has shrunk. Many people left the industry to seek alternate employment when the market deteriorated. Most will not return and it takes time to train new employees.

4) Equipment manufacturers – again, particularly those specializing in underground mining - scaled back their production capabilities when there was no market for their machinery. Now there is typically a year's lead time for filling orders.

5) Idled capacity – as opposed to permanent closures – is principally controlled by the Nation's largest producers. Examples include Peabody's Rawhide mine and Arch's Coal Creek mine which have 15 million short tons of idled annual capacity each. Today these are publicly traded stock companies.

Their Boards of Directors have a fiduciary responsibility to make cautious production decisions which will best insure an attractive, long-term return on capital for shareholders. They will not bring production back on line without serious forethought.

Now, facts in hand, let us move on to some of the conclusions CONSOL has drawn.

Near term we do not believe domestic supply can cover domestic demand. We have seen numerous reports projecting the shortfall anticipated in 2002...the largest being 69 million short tons in the Merrill Lynch document.

Such a shortage is bad news for our domestic customers, particularly the utilities. They need to put coal in storage. At 88 million short tons, their December 2000 collective inventory, these utilities had less coal on the ground than anytime since 1974. Current stockpiles remain at dramatically low levels.

Everyone is waiting to buy. They hope prices will go down from current levels. In the meantime, labor contract negotiations with the United Mineworkers of America at the end of 2002 keep getting closer. The power companies have to replenish their stocks between now and then or run the risk of being caught short if – and its only an IF at this point - if there is a miners strike. Thus, it is possible that when they enter the market it will be en masse.

The preceding will result in continued upward pressure on pricing i.e., the gorilla will be even bigger and more irresistible in 2002 than he was in 2001. It is, therefore, our opinion that U.S. exports, which totaled almost 57 million short tons in 2000, will go down in 2001 and be even lower in 2002. Further, I have seen some projections which show exports dipping as low as 35 million short tons by 2005. This is a far cry from 100 million short tons at one point in the early 1990's and 89 million short tons as recently as 1996.

The solution to the shortage of coal for U.S. domestic customers, and for keeping coal in the export market, is one and the same. ADDITIONAL PRODUCTION! Our mining industry has the reserves and the ability to produce from them. To put them in play, however, we need two things from our customers...longer-term sales commitments and assurance of a reasonable return on capital invested.

We are beginning to discuss both with domestic utilities, industrial consumers and steel companies. They have started to acknowledge that spot market purchasing is no longer as likely to get the job done. Instead they are now considering buying under multi-year arrangements with price mechanisms that moderate the huge swings caused by spot market volatility.

The fact that buyers were unwilling to move in this direction earlier is what has kept the U.S. coal industry from launching green field projects. At CONSOL, the last major metallurgical coal mine we opened was Buchanan in 1983. Our last green field project for thermal coal was Jones Fork, opened when George Bush was President...the OTHER George Bush.

With new capital projects difficult to justify, CONSOL's focus has been on increasing productivity and production at existing mines. For example, we have increased the originally planned 1.5 million short ton per year production of Buchanan to 4.9 million short tons per year through incremental expansion projects. Unfortunately the "easy", low cost expansion there has been implemented. Further expansion will require almost the same significant level of capital investment required for the development of a new mine.

Capital for a large new long wall operation is roughly $50 per annual short ton of production. The limited mine expansion opportunities still available to us would probably cost $35 - $45 per short ton of annual production...just about the same. Based on these numbers, the cost of either a new mine or an expanded Buchanan would require a short ton mine price in the mid $30 range.

We are considering a Buchanan expansion case now. When our Virginia Pocahontas low volatile metallurgical operations close in 2004, we will lose 2.7 million short tons of annual production. Expansion of Buchanan is the quickest way to replace part of the Virginia Pocahontas coal. In as much as our current mine price per short ton is close to the mid $30 range, at minimum we will need agreement with future customers on a contract pricing mechanism which will keep pace with inflation from this point forward.

Whether or not we proceed with the Buchanan expansion will depend upon several of you in this room, as well as our clients in Europe. Combined, South America and Europe represent the majority of Buchanan sales. Thus, you can be assured that when CONSOL comes to negotiate at the start of 2002, we will be asking all our export customers to consider the same type of commitments we are discussing on the domestic side. Specifically, we will ask for longer-term sales agreements. We will also seek a pricing mechanism other than simple annual nomination. Examples might include cost plus, base price plus indexed adjustment, or even annual nomination with caps to limit movement to a maximum amount up or down.

For overseas buyers to keep U.S. coal in the export market they will need to incorporate these term and pricing concepts into their purchase agreement models. If they do not, there will be a shortage of U.S. coal to meet their requirements. What is produced will be shipped to consumers within the United States who are likely to offer these features. In short, do not assume the U.S. will continue in its "swing supplier" role. Assumptions have a way of becoming problematic as evident from another Chico story I can share with you.

"ASSUMPTION" STORY

On that note, my friends, I will ASSUME it is time to summarize my remarks and turn the podium over to my friend, Mr. Boyd Payne of Fording.

I have tried to bring you into the thought process of the U.S. coal producing community. I provided facts about domestic demand for our production and summarized the current supply situation. I shared with you CONSOL's belief that there is not enough U.S. coal being mined to cover our Country's near term coal requirements. I stated that coal buyers in the United States have begun acknowledging the need to offer long term sales agreements with more "producer-friendly" pricing mechanisms to encourage needed green field projects. Finally, I suggested export buyers would have to do the same if they wish to continue benefiting from the quality, security and source diversity of U.S. coals.

The U. S. apple tree has suffered from blight for a number of years. To survive we've had to do some pruning. Nevertheless, our roots are strong and the fruit we produce will continue to be excellent. All we need is some help to get a higher yield from our branches. If we increase the amount of apples produced, the gorilla can eat his fill AND we can satisfy our overseas customers. If we do not, it is probable U.S. exports will shortly be reduced to nothing more than applesauce!

Thank you for your attention.