

**CANADIAN COKING COAL:
HOW TO CATCH UP -
A New Era for Coal**

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INTRODUCTION

As this is the final Paper in this session dealing with metallurgical coking coal, I have the opportunity to offer some comments and insights from the producer's perspective into the future of our industry and market trends from metallurgical coking coal. I hope that my presentation on the Canadian scene completes the global picture of the seaborne coking coal when read along side the contributions made by my fellow Speakers.

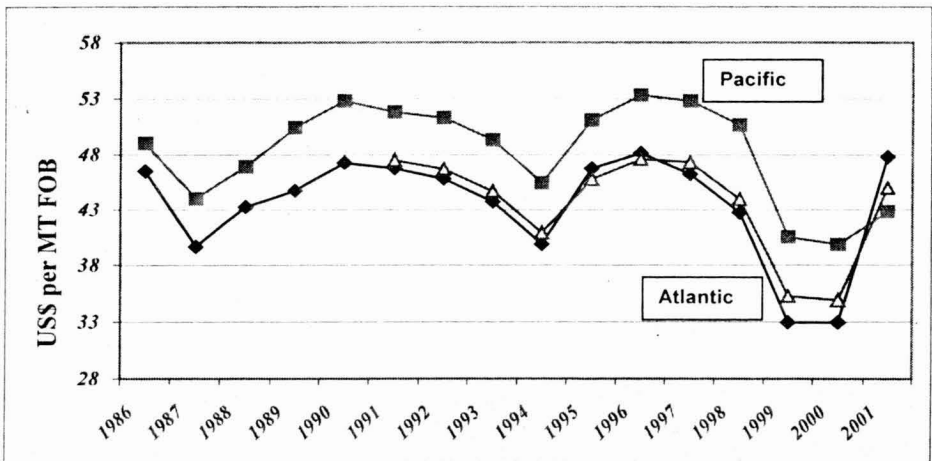
I would like to start by briefly summarising the most significant events that have affected coking coal producers in the period 1999 – 2001. Simply stated, the seaborne coking coal trade underwent fundamental changes, largely as a consequence of global macro-economic events that were largely unforeseen by governments, steel companies and coal suppliers.

As we all remember, the economic crises that impacted many economies in 1997 - 1999 led to a greatly reduced demand for coking coal, particularly in the latter half of 1998. This collapse in coal demand came at a time when Australian suppliers were increasing production by developing new mines and improving mine productivity, by making substantial changes to mining practices that led to lower operating costs at the older operations.

A fall in the Australian Dollar exchange rate, and historic low sea freight were further factors that contributed to an extremely competitive coal market.

The result was a heavily oversupplied coking coal market that, in turn, led to a collapse in coking coal prices. Hard coking coal prices fell by over 30% in many market sectors, as producers struggled to maintain market share and buyers took full advantage of the windfall. Consequently, while coking coal prices in north Asia remained around \$40/ MT FOB, prices elsewhere fell to unprecedented levels, in some cases below \$30/ MT FOB.

Chart 1
Coking Coal Price Trends
1986 - 2001



This dramatic collapse in the market price in 1998 – 99 came after nearly 20 years of persistent over supply; fundamental market forces of supply and demand eventually led to significant rationalisation of coal supply in 2000, as high cost supply was forced out of the market.

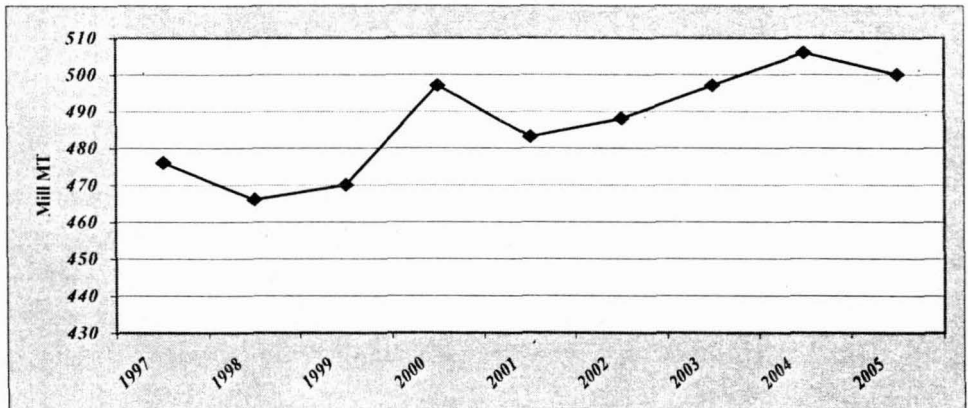
The shutdown of the Quintette mine (3 mill MT p.a.) in north-east British Columbia is one example of the impact of low coal prices. Closure of high cost / low productivity operations in New South Wales, Queensland and in Appalachia (USA) are further illustrations of the market response to low coal prices.

As shown in Chart 1, coal pricing has normalised in all markets in 2001. In my talk today I would like review some of the key factors that impact on coal pricing and future price trends, trusting that my comments and observations will provide the Canadian perspective of global coking coal markets.

SEABORNE COKING COAL - SUPPLY/DEMAND BALANCE

Since the low levels of 1998-99, blast furnace steel production has rebounded and further steady growth is forecast into 2005.

Chart 2
BOF Steel – Global Production Trends
1997 - 2005



(Source: CRU International)

As a consequence of the growth in blast furnace steel production, World seaborne demand for coking coal (excluding PCI), increased by around 4 million tonnes between 1999 and 2000 to 164 million tonnes (Source: CRU International).

Current projections show this demand remaining stable at least until 2005. Despite the overall 'flat' demand, seaborne coking coal requirements will increase more dramatically in several countries, most notably India and Germany, where growth rates may exceed 5% per annum as domestic production is replaced by imported coal.

Under this scenario pulverised coal injection (PCI) is likely to be maximised. Growth prospects for higher quality coking coal are therefore particularly strong, due to the need for high strength coke to support blast furnace burden at the projected high PCI rates.

On the supply side, 1999 was a devastating year for US coking coal suppliers as FOB price levels dropped below their average cash cost of production. US seaborne coking coal supply reduced by 13 million MT between 1998 and 1999 bringing their seaborne exports to a record low of around 26 million MT. With JFY2000 prices falling a further 5% in Japan US suppliers were virtually eliminated from the Japanese markets, and it is now clear that exports will be even lower in 2001.

Canadian producers reduced their seaborne exports of coking coal from 28 million tonnes in 1998 to around 26 million tonnes in 2000. Over the next three years it is inevitable that further changes take place in the Canadian supply picture. Several mines will exhaust their recoverable coal reserves, and be shut down. It is unlikely that current economics will allow new mines to be built in Canada to replace this obsolete capacity.

Coking coal shipments from Canada will become more concentrated from the Vancouver area ports. Mines in south-east British Columbia will increase production to maximum capacity, and Canadian exports should stabilise at around 23 million tonnes in 2003. Reserves exist to maintain this level of production and exports for more than 20 years, and a number of new coking coal mines could be developed, based on proven reserves of good quality coking coal close to existing infrastructure, in case market conditions could support such investment.

Australian producers increased production by nearly 10 million tonnes between 1998 and 1999, due largely to the development of 3 new mines dedicated to export of coking coal, but also through expansion of some existing operations.

China is slowly emerging as a coking coal supplier, however, it is anticipated that the market penetration will be via Asian steel-makers, with an initial focus on delivery of soft coking coal.

In examining the supply / demand balance into 2002, there are indications that additional supply is required to maintain an overall balance, provided that steel production is maintained at present rates.

CHANGES IN GLOBAL COAL TRADE PATTERNS

The massive swings in supply sources over the recent years, as Pacific suppliers have become the dominant, have created two distinctly different market conditions. Ocean freights and delivery logistics have become even more significant factors in coal purchasing decisions:-

- In the Atlantic region, there is a shortage of higher quality coking coal at current pricing levels. US coal exports continue to decline in the face of stronger domestic opportunities, and in some cases, mining difficulties at key operations that have previously been significant suppliers to the export market. Poland

has pulled back from seaborne markets, directing coal towards proximate steel-makers.

- In the Pacific region, Australia has become the dominant supply source and the U.S. has been virtually eliminated as a supplier. Steel-makers in Japan and Korea have learned how to make high quality coke without using US coal in their blends.

Canada has cemented its position as the World's second ranked supplier of seaborne coking coal. Market diversification, particularly away from Japan, is the obvious strategy for Canadian suppliers as opportunities emerge in other markets. The increased delivery of Canadian coal to the Brazilian steel mills shows the mutual benefits of such diversification.

However for proper mine planning, which is the key to the maintenance of low cost mining operations, suppliers such as Fording Coal seek long term sale/ purchase arrangements. Long-term arrangements are central to the development of partnerships between coal and steel producers, in order that security of supply can be guaranteed.

Australian hard coking coal suppliers will maximise production from existing mines but again, it seems unlikely that apart from the recently announced Hail Creek project, any more new greenfields coal mine can be successful unless coal prices remain at sustainable long-term levels.

Traditionally the U.S. industry has been a 'swing supplier', exporting coal when market conditions were favourable and withdrawing at other times. Whether the U.S. coal can return to the export market remains to be seen, however, it is certain that further investment capital is required if these mines are to become competitive with low cost production from Australia and Canada.

In the event that the present market conditions are maintained, the extent to which high priced U.S. coals can be replaced by Australian and Canadian coal will surely be a matter of intense scientific study and debate!

FUTURE COAL PRICES

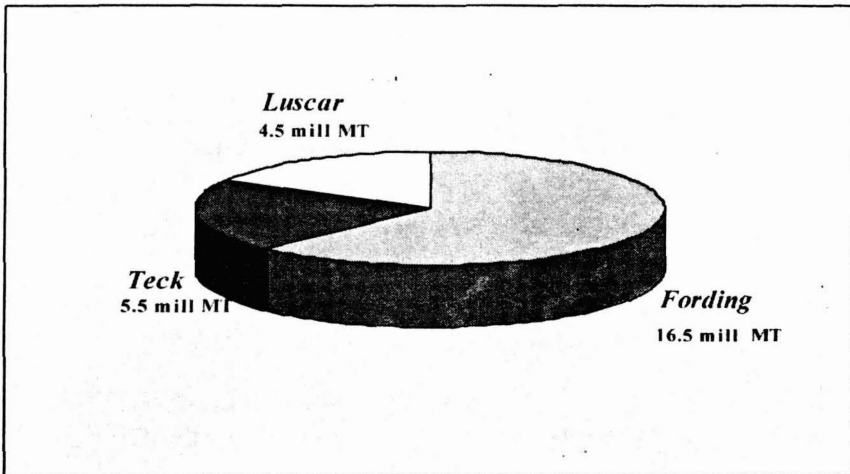
In recent years markets have responded to:-

- increased global demand for coking coal, and,
- restriction in supply due to mine closure, and,
- the removal of market distortions created by the long term purchase commitments in Japan, and,
- strong energy markets in the USA.

It has been said that predicting the future should be the exclusive duty of Prophets and soothsayers. Accordingly, I would like avoid making firm projections of coal price and instead briefly to discuss some of the factors that will certainly impact pricing strategies over the next few years, as these factors will be the keys to understanding market trends:-

- There are now fewer, larger producers of coking coal dedicated to seaborne markets. The Canadian industry is an illustration – today three producers account for 100% of the production, compared to 6 producers 5 years ago and 9 producers 15 years ago.

Chart 3
Structure of the Canadian Export
Coking Coal Industry
2001



- Simply stated, the average FOB pricing for seaborne coking coal in 1999 – 2000 was too low to sustain adequate levels of supply, and to secure the support of the investor community. The price recovery witnessed in 2001 negotiations was a necessary adjustment to ensure on-going supply of coking coal.

Today Canadian coal producers are barely meeting shareholder expectations, despite the rather significant changes in the industry over the past 2 years.

In Australia, some low cost producers are profitable, but overall the industry must continue to improve and repeatedly demonstrate adequate returns to the shareholders.

It is a reality of the market that, at the moment, there are no viable alternatives to the large / efficient / low cost coking coal mines in Australia and Canada. Steel-makers should be comforted by this fact, particularly as these mining operations are dedicated to supply coking coal to the World steel industry.

However, a significant factor in maintaining high productivity / low cost operations is the ability to secure replacement capital to replace obsolete and worn-out mining equipment. Investors must have confidence that the coal industry can afford and repay funds invested in innovation and mine maintenance.

It is a fact that, despite the improved outlook for coking coal, coal mines are for sale in all producing regions; further rationalisation and consolidation of ownership is inevitable.

As production is consolidated into the hands of few companies, the possibility of tie-ups between the emerging steel alliances and individual coal suppliers bears close study.

- Coal producers are increasingly likely to be publicly listed companies, rather than subsidiary divisions of large corporations. Oil majors have exited the industry, and capital must now be secured from the investor community. Decisions will be responsive to the demands of the investor community for adequate / superior returns on shareholder provided funds. In the future, lenders to the coal industry will be far more demanding, insisting that new projects have the prior support of the market before financial commitment and approval to finance the project.

Furthermore, decisions by coal executives on such matters as coal price, production levels, market diversification, negotiation tactics and strategy, and

business investment will increasingly require that a balance be struck between shareholder returns in the short term and the sustainability of the coal and steel industries over the longer term.

As an illustration, US coal producers turned away from the coking coal export markets in 2001 as financial returns were generally inadequate against the domestic opportunities. The best revenue option was apparently chosen by the coal producers, regardless of any potential damage to relationships with the steel producer.

However whilst the changes I have described have made a stronger coal industry, I believe that coal producers are rightly concerned about the viability of steel industry, given the current oversupply situation and low steel prices on international markets. Rationalisation of ownership and production in the steel industry is underway, and further changes are anticipated. Coal producers will be watching these changes with a keen eye – the events of these past three years have clearly demonstrated the linkages between the coal and steel industries are as strong as ever.

All in all, in spite of the hardships endured by coking coal suppliers over the past 15 years, and particularly in the crisis of 1998 – 2000, a more stable seaborne coking coal market has emerged. The many changes have led to a 'healthier' supply group that is now better positioned to meet the long-term needs of the global steel industry.

For the competitive Canadian coking coal producer, the future holds a promise that the uncertainties of the past will be replaced by a more stable and rewarding marketplace, to the long-term benefit of producers and their valued steel industry customers.

Thank you for the opportunity to address this Assembly