

Kobie Koornhof Associates Inc.

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# **Metcoal Market Update**

## **January 25, 2019**

***“2018 is on track to be the first year since the Global Financial Crisis that the global economy will be operating at or near full capacity” – The World Bank  
May 2018***

***“The world industrial production cycle appears to have peaked in 2018. The extent of the expected down cycle depends on whether China can maintain economic growth as the US China trade dispute impacts.”  
Resources Quarterly Dec 2018, Australian Dept of Industry, Innovation and Science***

***“After two years of solid expansion, the world economy is growing more slowly than expected and risks are rising. But even as the economy continues to move ahead ... it is facing significantly higher risks.” – International Monetary Fund January 21 2019***

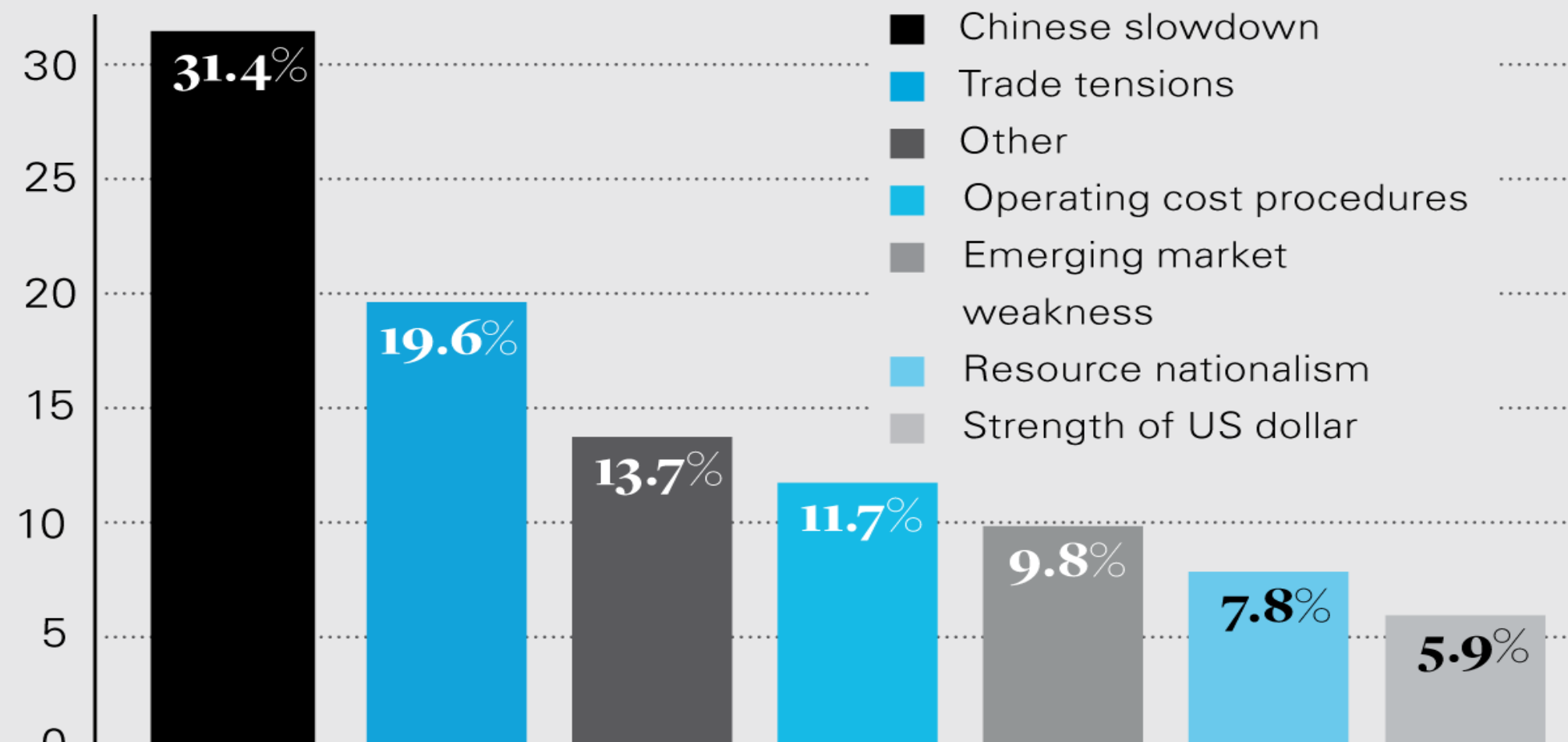
## **TWO QUESTIONS THEN....** ***(This is not Rocket Science)***

- **What will happen in China?**
- **What will happen outside of China?**

***“A worsening of the ongoing economic slowdown in China, consumer of about half the world’s commodities, is the single biggest challenge mining and metals companies face this year” – White and Case Mining and Metals Survey 2019***

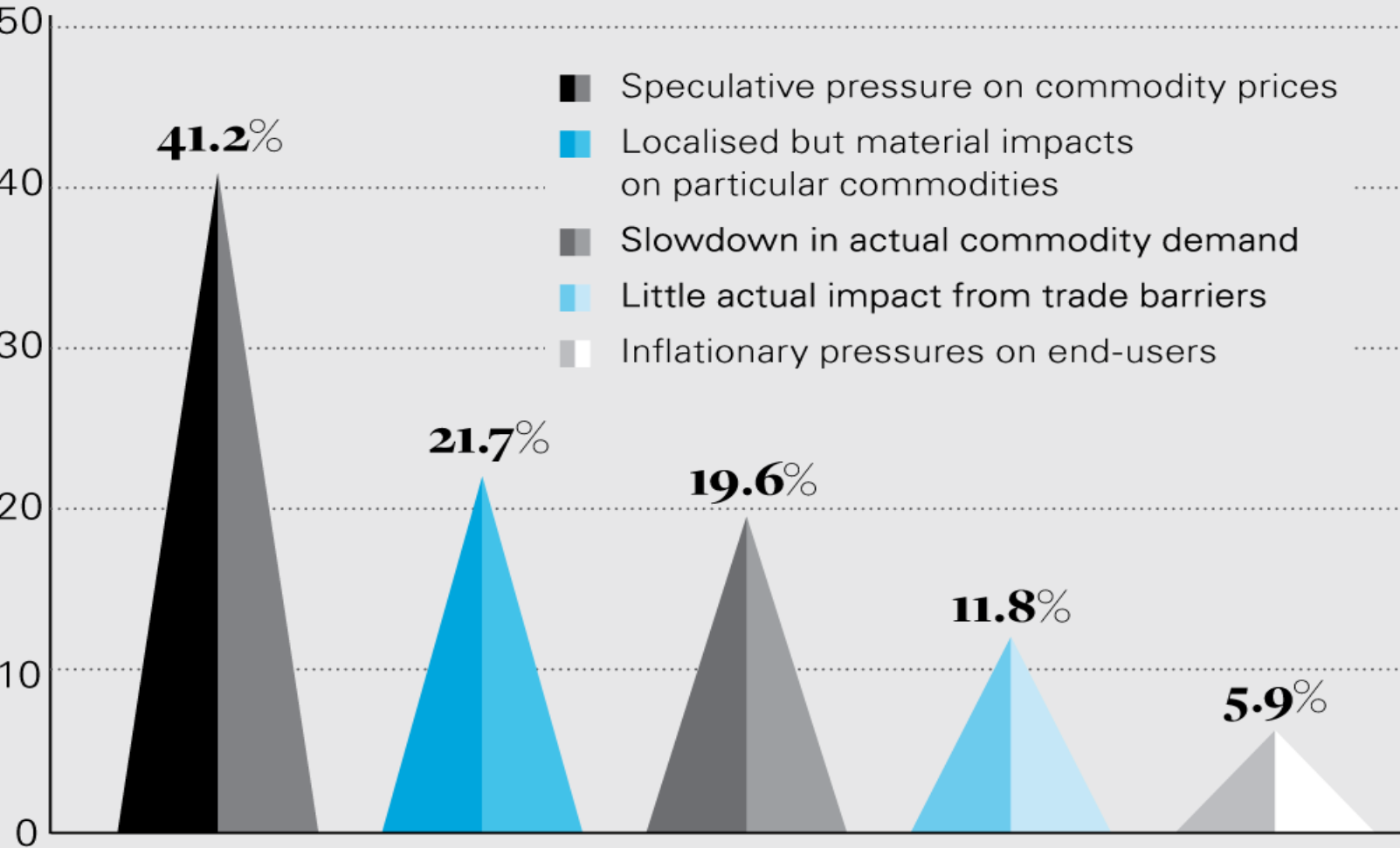
# White and Case Mining and Metals Survey 2019

## What is the key risk for mining & metals in 2019?



# White and Case Mining and Metals Survey 2019

## What impact are trade tensions likely to have in 2019?

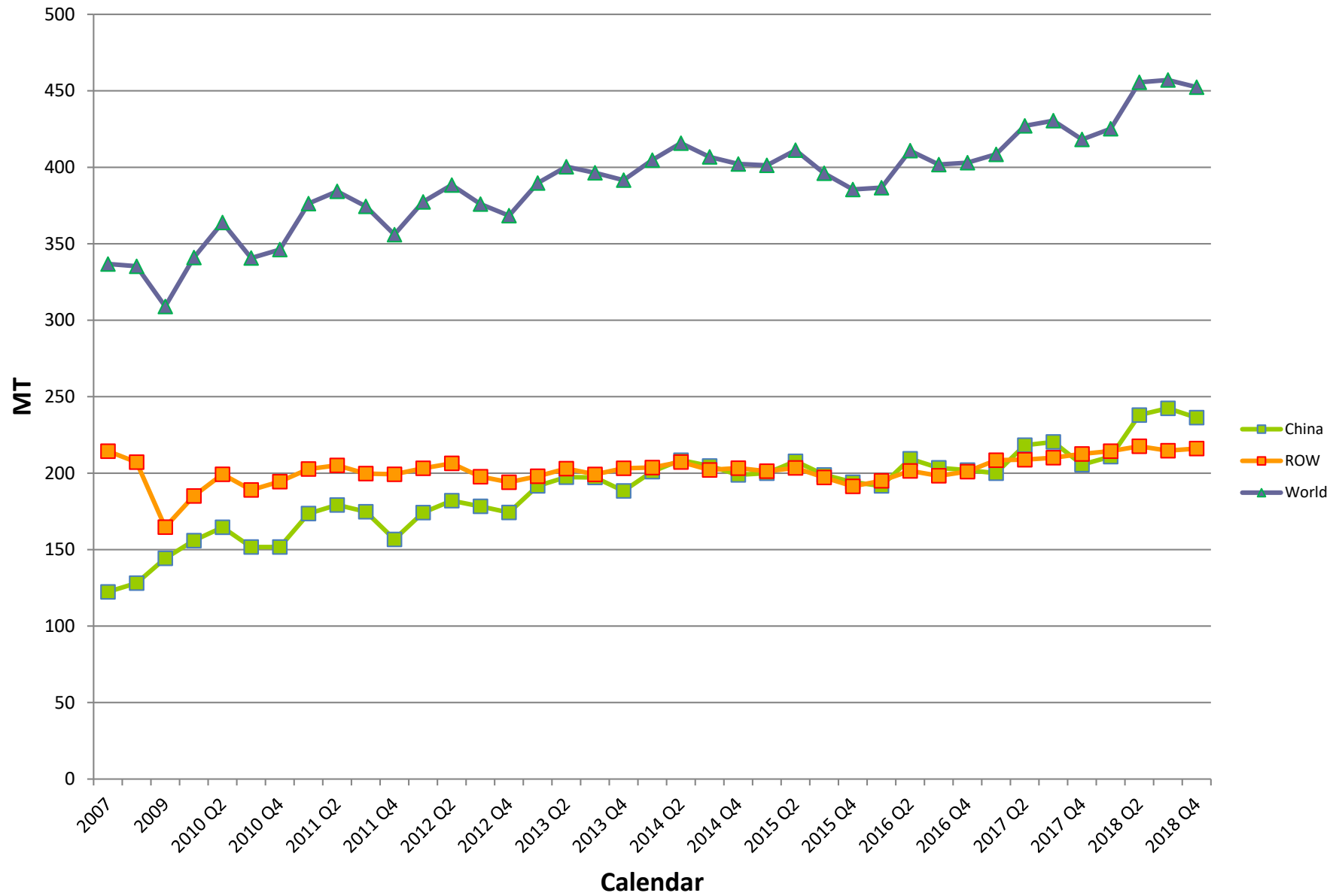




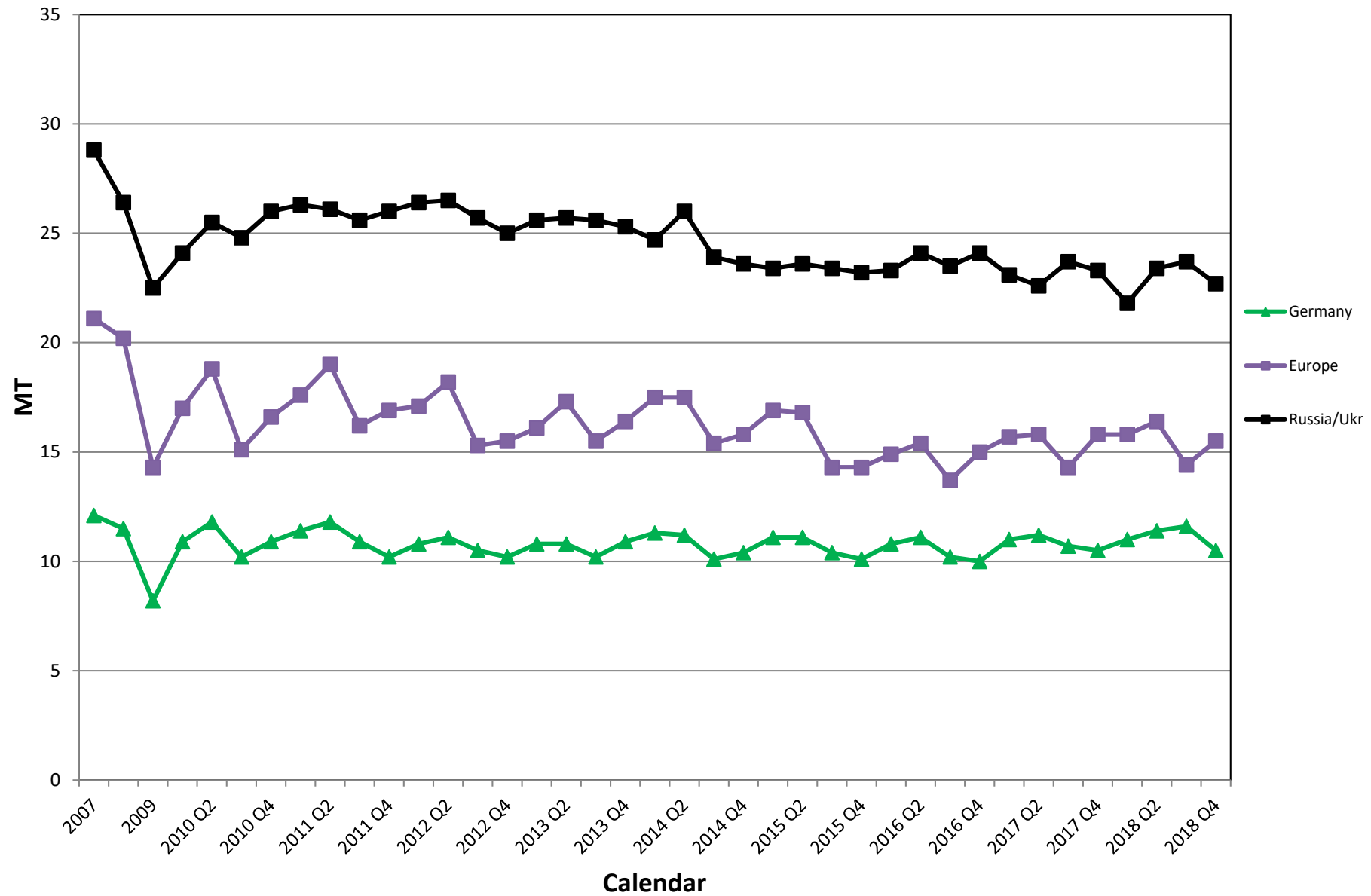
# STEEL INDUSTRY

- Steel industry in 2018 maintains recent strong performances
- Global crude steel production reached 1,789.6 million tonnes (MT) for the year 2018, up by 4.5% compared to 2017
- China up 6.6% to 928.3 Mt; India up 4.9% to 106.5, Japan flat at 104.3
- China increases its share: now 52% of CSP vs 51% in 2017; India at 6%
- Blast Furnace Iron up 2% to 1,239 MT, China produces 62%

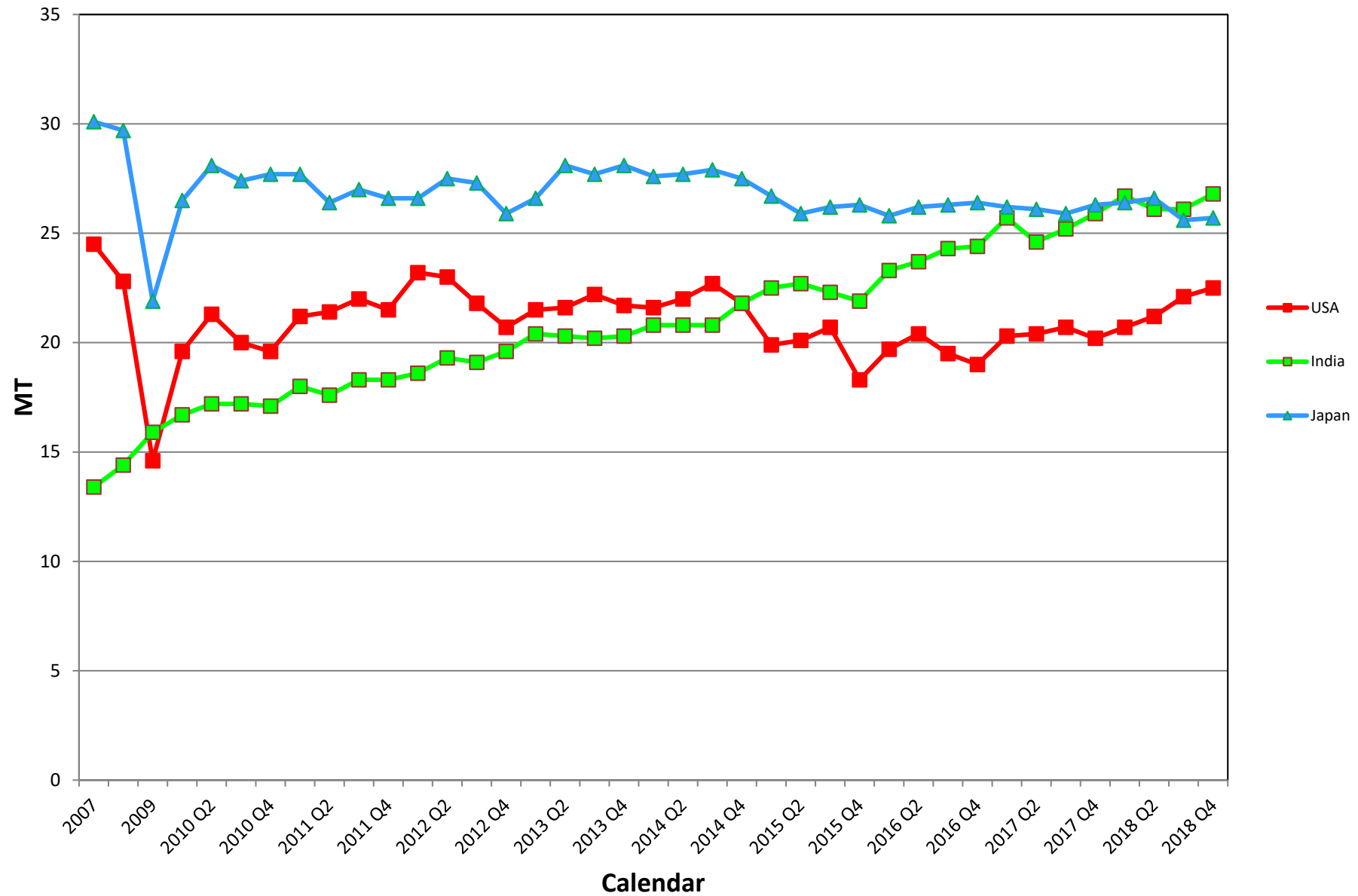
## Crude Steel Production



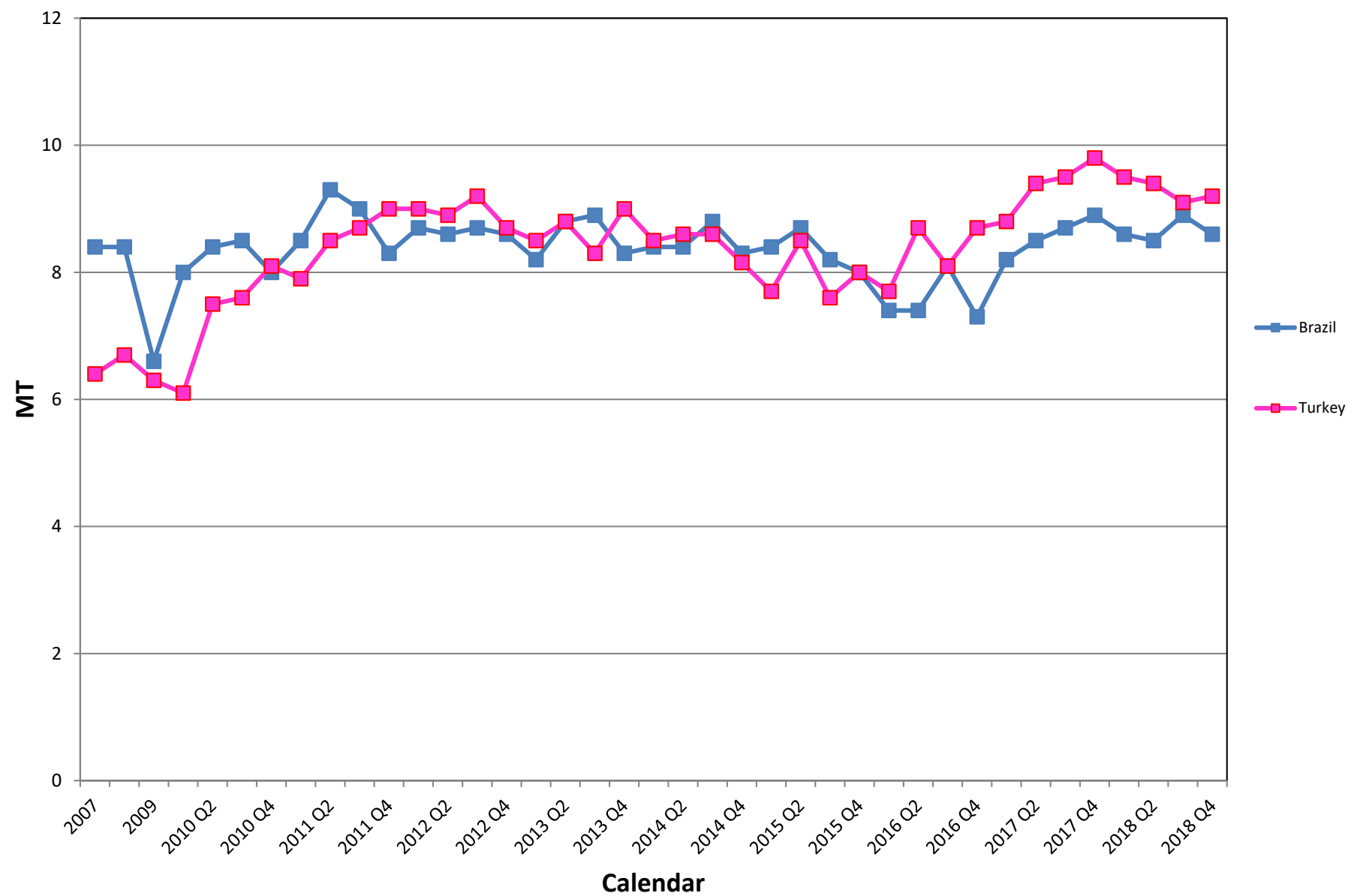
## Crude Steel Production



## Crude Steel Production



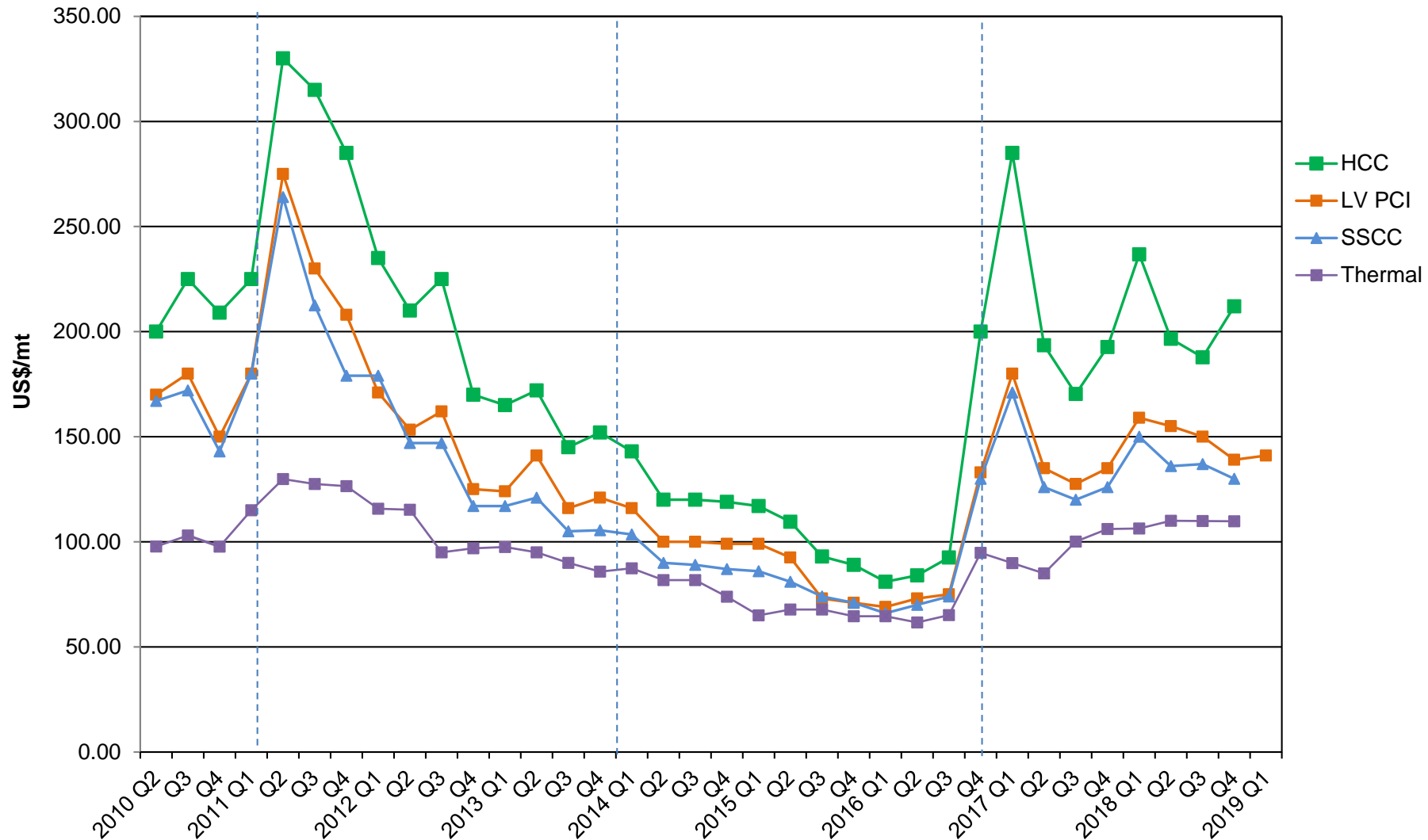
Crude Steel Production



# Steel Production 2018

- Strength in HCC importing countries:
- Turkey **flat** -
- India **↑ 4.9 %** - *Q4 2018 highest quarter ever*
- Brazil **↑ 1 %**
- China **↑ 6.6 %**
- South Korea **↑ 2 %** - *Q4 2018 highest quarter ever*
- Taiwan **↑ 3.5 %**
- USA **↑ 6.6 %**
- World **↑ 4.5 %**
- **World Excl. China 2.5%** - *Q4 2018 highest quarter ever*

# Quarterly Coal Prices



# METCOAL SUPPLY/DEMAND IN 2018

- **Demand Side**

- Strong demand in all regions
- World steel production up by 4.5% to record 1.79 BillionTonnes
- Chinese coal supply constrained by environmental inspections and safety inspections following a spate of fatalities.

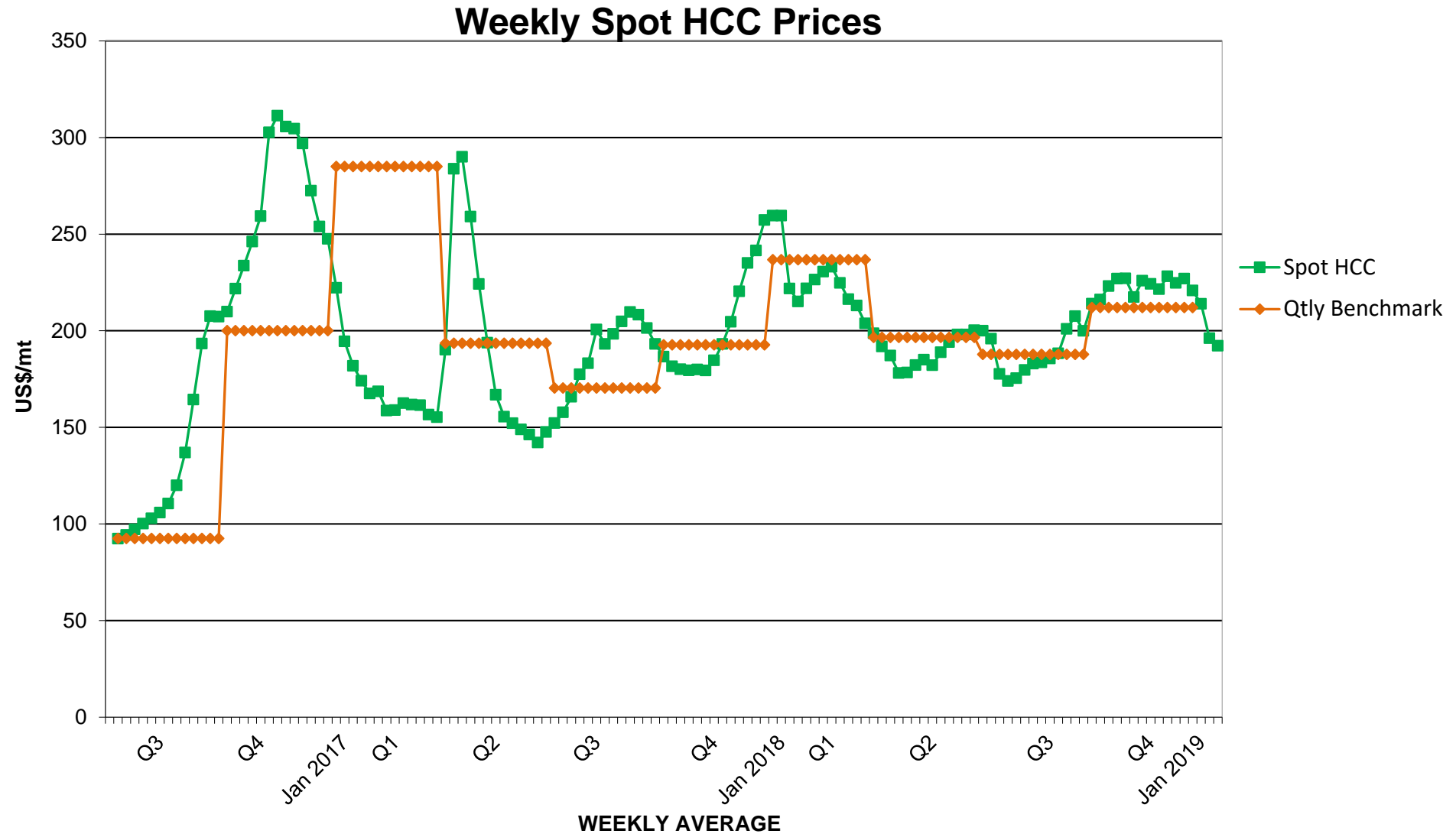
- **Supply side**

- Vessel queues in Australia higher than normal due to rail slowdown
- Supply issues in Queensland – North Goonyella fire takes out 2.5 Mtpa capacity Tier 1 coking coal
- Closure of the Pinnacle low vol mine in the US



**The upshot of all that is an average spot price of \$207/tonne for 2018, which is 29% above the 2017 price of \$161/tonne**

# Recent Spot HCC Prices



***“There's an old saying in commodities: nothing destroys high prices like high prices ” – Any number of Commentators***

## WHAT'S HAPPENING RIGHT NOW....

- **Seaborne coking coal prices started the year in retreat**
  - 17 weeks of plus \$200 pricing falters .... Now in the \$190s
  - uncertainty about China's growth prospects in 2019
  - Fears of a global slowdown
  - buyer cautiousness around the sustainability of steel margins
- **European market softens**
  - German spot buying slows down
  - Concerns for automakers
- **Brazil quiet on spot markets**
- **Indian buyers waiting for price to drop further – fingers burnt?**

## WHAT'S HAPPENING RIGHT NOW....

- **But** – Baowu increases steel prices in first week of January ahead of construction period when demand is at its highest.
- Shortage of domestic Chinese HCC supply due to safety check following mine deaths
- Spot price quickly recovers to \$197 from \$191

# CHINA STEEL

- China accounts for 52% of world steel production but more importantly, it accounts for 62% of Blast Furnace iron production.
- Between 2006 and 2015, Chinese steelmaking capacity more than doubled, from 488 Mtpa to 1,150 Mtpa
- Overcapacity has been a problem, hence 150 Mtpa to be cut by 2020.

# CHINA STEEL

- Crude steel production rose 6.6% to a record 928.3 Mt in 2018
- Chinese steel company profits up 7.5% Jan – Nov 2018 from 4.9% in 2017
- Growth continues as the Govt tries to minimize impact of US tariffs on Chinese exports:
  - relaxation of monetary policy
  - increased infrastructure spending
  - possible relaxation of winter steel production curbs

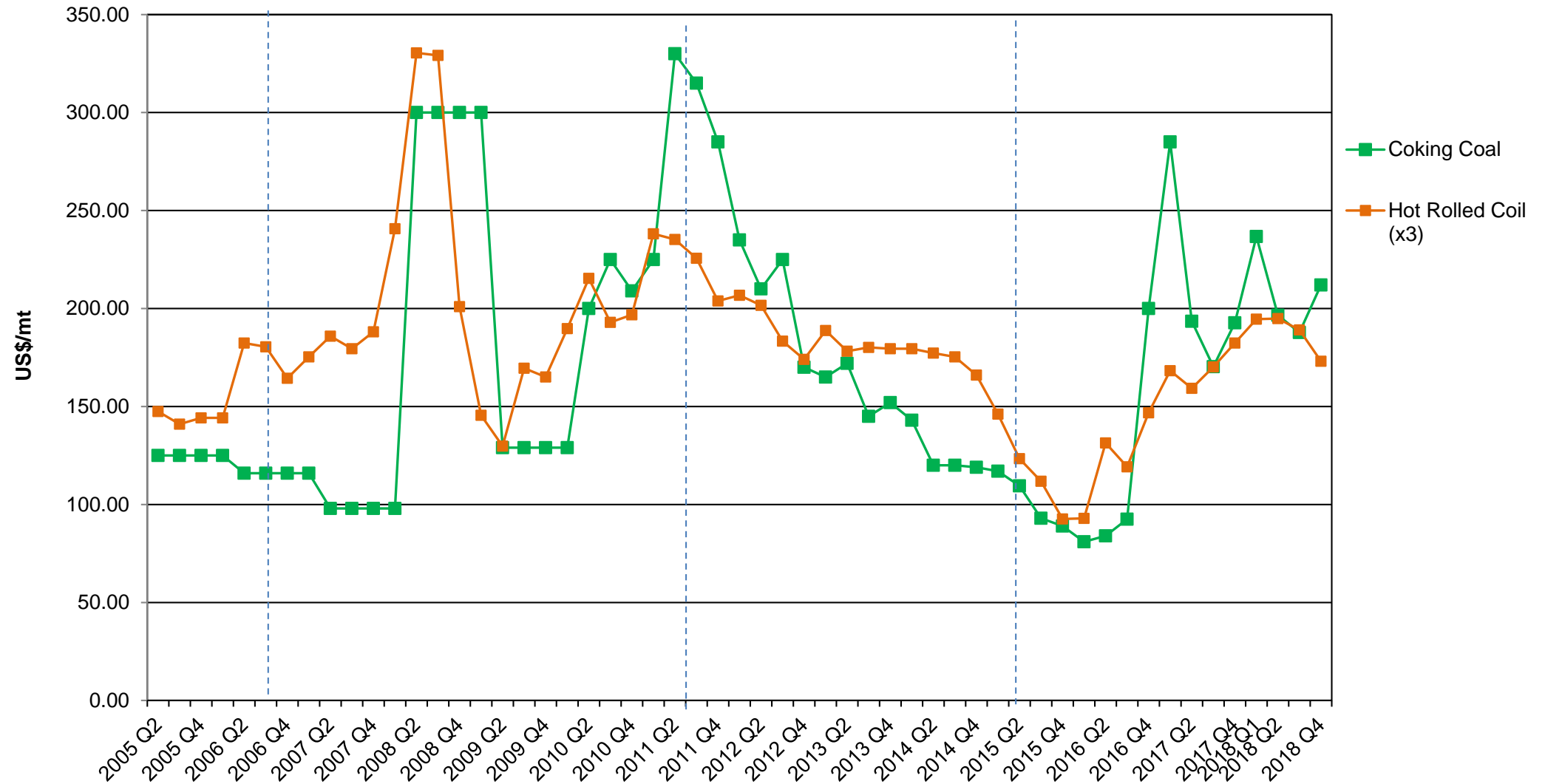
# CHINA CAUTIONARY NOTES

- Chinese economic growth came in at 6.6 percent in 2018 — the slowest pace since 1990, and forecasts of growth less than 6% pa going forward.
- China's crude steel production is forecast to fall below 900 mt in 2019 due to drop in GDP, although steel consumption is expected to remain flat in 2019 at 781 Mt

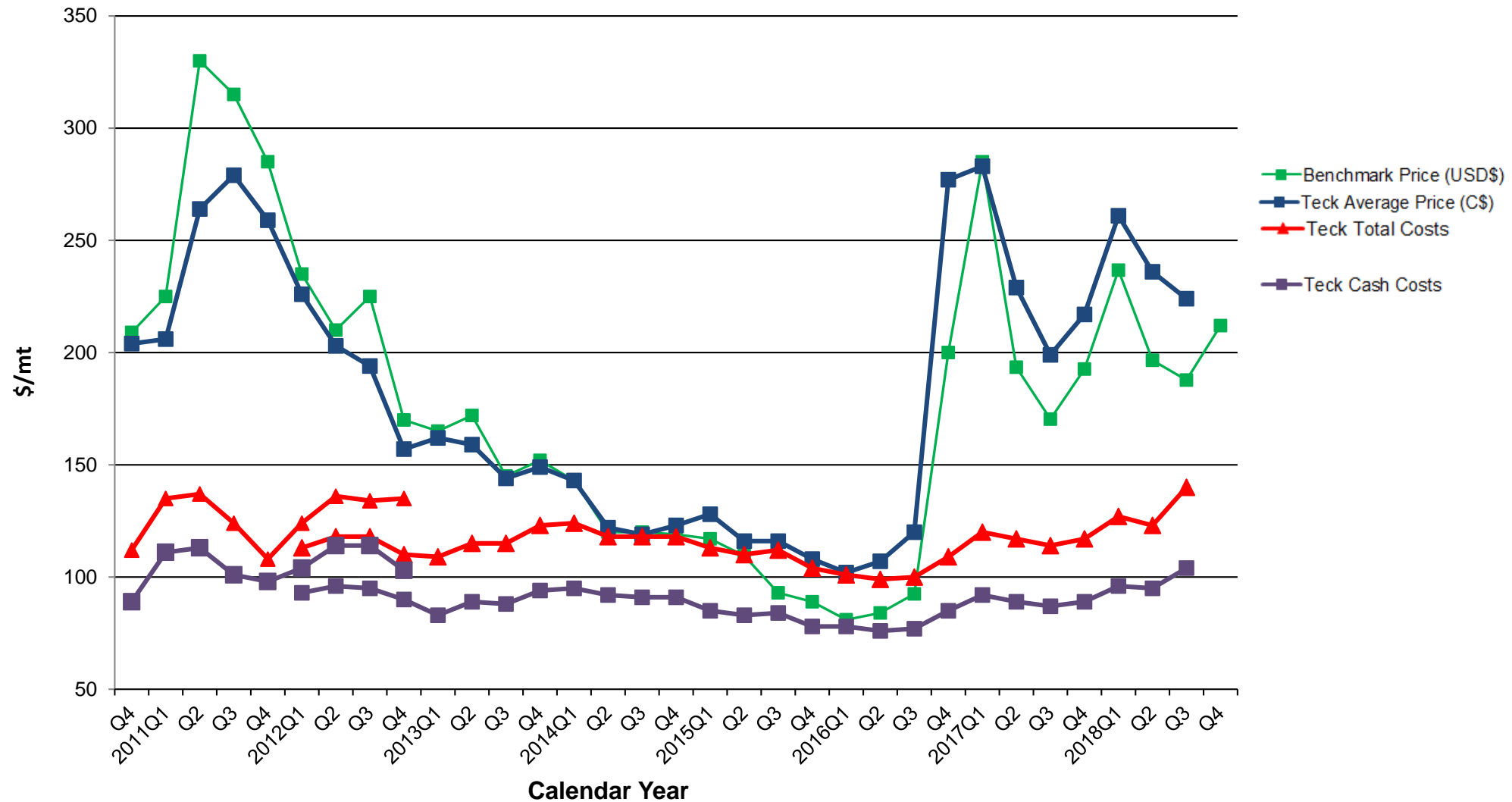


# Coal Price vs Price of Steel

## HCC Benchmark vs HRC World Price



## Teck Coal in the Current Market



# TECK....

- **Costs increase % in 2018**
  - use of contractors to capture additional margin in the current strong price environment
  - inflationary pressures on particularly diesel
  - maintenance shutdowns at Fording and Elkview
  - mining in higher cost areas
  - Trucking Elkview coal to the Coal Mountain plant while Elkview is being expanded (400k tpa)
- **2019 ....**
  - Plant maintenance now complete
  - Moving to lower cost areas
  - New life for Cardinal River
  - Cash available for growth projects .. Neptune, Elkview, Line Creek, CRC expansion the current focus
- **Production Q3 2018:** 18.9 Mt vs 19.7 Mt in 2017 Full year 26-27 Mt, low end of range
- **Logistics challenges in 2018:** Production was 26.6 Mt in 2017, 27.6 Mt in 2016

## DEMAND SHORT TERM

- In 2019, Worldsteel forecasts global steel demand to grow by 1.4% to reach 1,681.2 Mt from 1,657.9 Mt
- Broadly speaking, 23 Mt increase in steel production requires roughly 13 mt additional HCC supply - pretty much what is expected in supply increase in 2019:
  - Australia 7, Mozambique 2, Canada 2, Russia 1?

# DEMAND LONG TERM

- IMF expects **World GDP to increase** by 3.6 – 3.7% over the next 5 years
  - Brazil 2.2 - 2.4%; Germany 1.2 - 1.9%; Japan 0.5 - 0.9%; Korea 2.5 - 2.8%; Taiwan 1.9 - 2.4%
- China's One Belt One Road initiative is expected to drive growth through south and southeast Asia; BHP estimates steel demand of 150 Mtpa over the 10-15 year timeframe of construction.
- India GDP up by 7.3% in 2018, expected to stay well above 7% pa going forward

## DEMAND LONG TERM

- Even with forecasts of declining steel production in China, seaborne HCC demand will increase
- Many “cleaner” Blast Furnaces are being relocated to coastal locations to meet emissions standards.
- Smaller Blast Furnaces are shutting down, the larger units need high quality imported HCC

# SUPPLY OUTLOOK

- Supply stable in the short term:
  - Dry summer forecast in Australia; rail and port functioning well
  - But - Russian export coal is being limited due to rail congestion
- Global coking coal supply is not coming on line at a pace that will upset the current supply/demand balance
- Some observers are seeing a supply shortfall over the next 5 years.
- Multi-commodity majors such as BHP and Anglo have said that coal will struggle to compete for capital against other commodities

# INDIA 300 MTPA STEEL PRODUCTION CAPACITY

- National Steel Policy of 2017 targets steel capacity increase from 125 Mt to 300 MT by 2031, production rising from 105 MT to 255 MT
  - That's an annual increase of 5 Mtpa HCC per year or 70 mt additional HCC demand over the period; nice but how realistic?
  - The extra 175 Mtpa capacity will require extensive mobilisation of natural resources, finances, manpower and infrastructure
  - per capita consumption of steel increasing from 63 kg to 160 kg by 2030 i.e. 6.8% CAGR in steel usage vs 4.6% CAGR in previous 14 years. China achieved 7% CAGR last 14 years, so ....





# INDIA 300 MTPA STEEL PRODUCTION CAPACITY

- **But:** China's urban population grew by 3.2% pa in that time, India only expects to grow by 2.3% pa to 2030.
- **WAIT:** India grew its steel production by 9% pa over the last 14 years (from 33 to 105 Mtpa), surely it can achieve 7% pa over the next 14.
- **EXCEPT** that in 2005 capacity utilization was a meagre 68%, it is now 81%, so they didn't actually build all this new infrastructure
- **ALSO**, the target CSP of 255 MT in 2031 requires 85% capacity utilization vs 81% today. No-one is above 82% .. Japan/Korea ..

## **WRAPPING UP THE KEY ELEMENTS OF THE METCOAL BUSINESS....**

- **Crude Steel Production**
  - **Steel Demand is solid, some questions about Economic Growth**
- **Steel Industry Profitability**
  - **Steel Prices under pressure, industry still profitable**
- **Demand for Metallurgical Coal**
  - **BF Iron production up 2% in 2018**
- **Supply Availability**
  - **Supply is well balanced, profitability supported by sales prices**
  - **Questions about long term supplyability**

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Thank you!

***“The met coal price rally of 2017 will likely peter out in 2018, particularly as Chinese import demand slows off its torrent 2017 pace. We are modeling \$150/mt met coal (current spot price = \$210/mt) for 2018” – Senior Industry Analyst***  
***Actual average for 2018 was \$208.***

# THE KEY ELEMENTS OF THE METCOAL BUSINESS..

- **Crude Steel Production**
- **Steel Industry Profitability**
- **Demand for Metcoal**
- **Metcoal Supply Availability**