INTUITION

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# A 'Perfect Storm' for Coal – something to cheer about?

*Anyone driving along the N3 in either direction can be forgiven for feeling totally at the mercy of the truck drivers, as you negotiate your way through what seems like a wall of metal. The bad news is that there has been a significant increase in coal-bearing tipper trucks since the war broke out in Ukraine. The good news is that thanks to them, tonnage through Transnet's Durban port has grown significantly. Coal exports have totaled 1.13 Million Tons (Mt) between April and July this year, 2.75x higher than the 0.41Mt reported for the entire fiscal year 2021/22. During the first half of 2022, global coal prices hit record highs, driven mainly by the Russian-Ukraine conflict. As global trade was affected, South Africa experienced increasing demand from Europe, who were hungry for our high-quality coal and who wanted to reduce their dependency on Russia. This article will delve into what has played out across the global coal market and its impact on the SA Fiscus. Is there more to come?*

Nick Rogers

**SPEED READ**

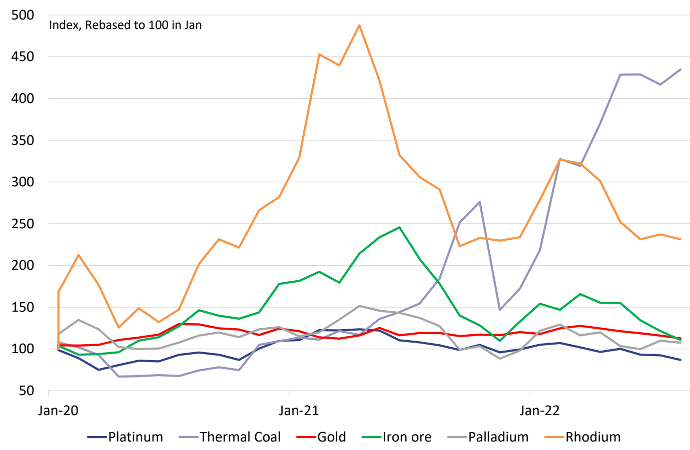
- **South African thermal coal shipments to Europe have surged by more than 700% in the first half of 2022.**
- **Coal is both the largest source of electricity generation (37%) and the largest single source of CO2 emissions, creating a unique challenge to global leaders aiming for a "Net-Zero" carbon world.**
- **Glencore, the world's biggest exporter of thermal coal, enjoyed a 900% jump in earnings to $8.9 billion for the 6 months to June 2022.**
- **South African coal miners are putting a combined 400 trucks on the road each day to mitigate disruptions and the unreliability of Transnet's railway network to the Richards Bay Coal Terminal.**

Firstly, how relevant is coal in today's world? Coal remains the largest and most widespread fossil fuel resource, accounting for c37% of the world's energy needs (IEA). Despite being seen as a "dirty" fossil fuel, it remains the best way to provide cheap and reliable baseload power, especially to developing countries like China and India - which combined account for 70% of demand. While metallurgical coal and thermal coal have similar geologic origins, their commercial markets and industrial uses are vastly different. Metallurgical coal or "coking coal" is mined to produce the carbon used in steelmaking and has a higher energy content whereas thermal coal is used to make the steam that generates electricity. Of the 6,529 Mt of coal produced annually, thermal makes up 83% (5,404Mt). Of this, 4,460Mt is used domestically whilst 926Mt (17% of total production) is exported and referred to as "seaborne". Over the past 2 years, a perfect storm has created an environment which has sent thermal coal prices to record highs. The key drivers are

1. In late 2020, China decided to ban Australian (#2 producer) imports of thermal coal, due to accusations regarding the origin of the Covid-19 virus.
2. Flooding in Indonesia resulted in the #1 producer cutting production over most of 2021.
3. As the world emerged from Covid-19 lockdowns, demand accelerated but supply-chain bottlenecks disrupted global commodity flows.
4. In January, Indonesia announced it was suspending all exports of thermal coal for a month citing a domestic shortage. Prices reached multi-year highs of $140-150/t
5. The EU imported 39Mt of coal from Russia in 2021, equal to 36% of total EU imports. Thus, when war broke out in Ukraine, thermal coal shot over $450/t to a record high due to supply being curtailed coupled with geo-political risks.
6. SA coal producers (#4) inability to meet 100% export capacity due to Transnet issues.

South Africa has benefitted tremendously from the recent commodity boom. In the 2021/22 financial year, prior to

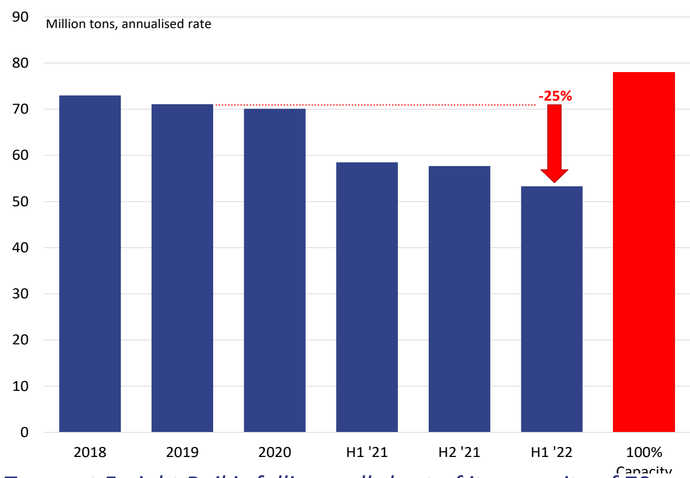
## KEY SA MINERAL EXPORTS




*Prices for some of our key commodity exports have surged over the past few years which has generated windfall mining royalties for the Fiscus.*

the Ukraine war, mining contributed R127 billion (40%) of SA's total corporate income tax of R318 billion. It is quite remarkable that during the dark days that followed Covid-19, amongst all the doomsayers, SA managed to record a current account surplus thanks to the soaring prices of iron ore, coal and rhodium. Granted, imports were depressed due to supply-chain issues and low economic activity at the time but nonetheless, the surplus on the Current Account creates much-needed positive investor sentiment. Minerals, including coal, made up more than 60% of South Africa's exports. Importantly, coal prices and export tonnage remain elevated which bodes well for the medium-term budget figures in October.

## VOLUME ON COAL EXPORT RAIL LINE




*Transnet Freight Rail is falling well short of its capacity of 78 million tons per annum*

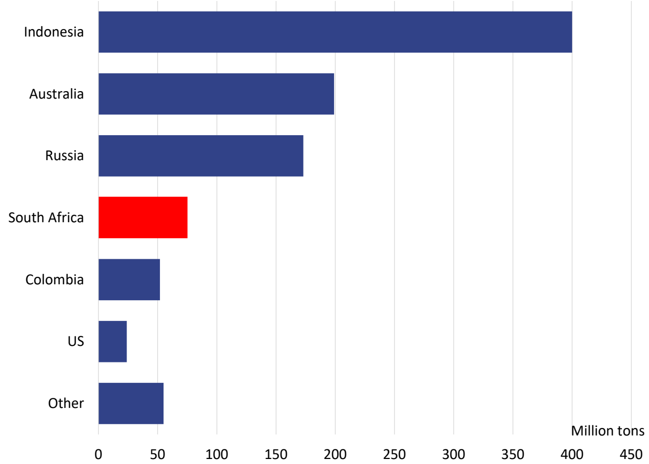
However, the Minerals Council of South Africa has repeatedly noted that SA has missed out on the true benefits of the commodity windfall due to the inability of Transnet to meet targets on its railway network. In the case of coal, that amounts to R16 billion in lost revenue alone in 2021. Last week, listed coal miner Exxaro, commented that "Locomotive unavailability remains a huge challenge, which combined with cable theft, vandalism and sabotage of rail infrastructure, is impacting our logistics chain." Exxaro railed 2.5Mt of coal to Richard's Bay Coal Terminal (RBCT) in 1H22, compared to 4.1Mt for the same period last year and well below its annual capacity of 12Mt. In April, Transnet declared force majeure on contracts with producers but with coal prices near record highs, mining firms have little option but to turn to trucks. Clifford Hallatt, COO at Canyon Coal, said, "It takes about 80 trucks, each carrying 34 tons of coal, to replace one average Transnet train, making it unsustainable financially, boosting emissions and clogging roads." Although trucking coal costs about four times more than rail, currently elevated prices mean that miners are willing to absorb these costs, for now. Combined, South African coal miners are putting about 400 trucks on the road a day. How long coal prices will remain high to mitigate these costs, especially with

*A common source of daily frustration for SA drivers. However, perspective is required.*

diesel at record highs, is the next question?

To try and answer this, one needs to look at the role of geopolitics - which has been central to explaining the volatility in energy markets over the centuries. A fortnight ago, Russian energy giant Gazprom tightened the geopolitical screws on Germany and the EU when it announced that its Nord Stream 1 pipeline would be shut down indefinitely, halting 40% of EU gas supplies. The announcement came just hours after the G7 leader's unanimous agreement to attempt to impose a "price cap" on Russia's oil exports. In the meantime, several European countries have been looking to use coal to make up for the short supply of gas. For example, German utility, Steag, is restarting 4 coal-fired power plants in November to ensure energy supply in the coming winter. As a result, South African thermal coal shipments to Europe have surged by more than 700% in the first half of 2022. It is hugely important that SA capitalizes on this crisis and the price-squeeze on coal. It is not all positive though. Due to the EU ban on Russian coal that came into force in August, India's thermal coal imports from South Africa slipped 32% YoY as they switched to cheaper Russian coal. Australia's thermal coal exports in August were 16% lower than a year ago, due to logistical challenges caused by rain, further supportive for prices in the short term whilst this key exporter faces supply constraints. It is thus very difficult to predict what will happen to both prices and demand over the next few months, especially whilst the war in Ukraine wages on. Standard Bank recently stated, "We believe a combination of demand destruction, due to high energy prices, and strong Chinese domestic coal production is likely to lead to a downward moderation in thermal coal prices by the end of 2022 and a much stronger correction in 2023." Time will tell. In the meantime, the EU are set to announce a raft of legislation ranging from price caps to potential windfall taxes on energy giants like Shell and BP.

**PRODUCERS OF SEABORNE COAL**




*All major producers of seaborne coal have experienced issues that have impacted production, thus contributing to the surge in coal prices*

In conclusion, it is imperative that SA coal miners and Transnet work together to ensure that no profits are left on the table, and to "never waste a good crisis". From an environmental perspective, what seems like a big step back may well accelerate the move towards clean energy. There are some tough challenges ahead, especially to ensure that energy flows smoothly over the European winter. The oil shocks of the 1970s resulted in major progress in energy efficiency, nuclear power, solar and wind. Today's crisis can have a similar impact and help speed up the shift to a cleaner and more secure energy future. Harvard House remains of the view that diversified miners like Anglo American, Glencore and BHP Group are best placed to benefit from both traditional and future energy opportunities.

*There is no question the coal industry is a dirty one, but in South Africa's context it does provide some economic and energy relief.*

Through a variety of news channels and daily commentators, investors are constantly bombarded with advice on where to invest their money. The most vociferous debates often occur between those who argue that everything should be offshore, and those who argue the opposite. Our next seminar will explore the merits of both markets, through the lens of our identified core themes, and explain why we feel it is wise to hedge your bets.

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**Topic:** **Why still Local AND Global**

| **Natal Midlands** | |
|---|---|
| Date: | 15th September 2022 |
| Venue: | Oasis Conference Centre, 72 Main Road, Howick |
| Morning Time: | 10am for 10.30am |
| Evening Time: | 5.30pm for 6pm |

| **Johannesburg** | |
|---|---|
| Date: | 20 September 2022 |
| Venue: | Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham |
| Time: | 7am for 7.30am |

## CONTACT DETAILS:

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