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Canadian coal stocks fired up as demand outstrips supply

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Consumption is up in China and other emerging markets, while Australian exporters faces woes

If you want to know how the Canadian coal mining business is doing, just ask someone in Tumbler Ridge.

A decade ago, people were predicting that the northeastern British Columbia community would soon become a mining ghost town - a victim of a dying coal industry. But now, with the coal mines humming and global appetite for Canadian coal surging, talk is not of how the town will survive, but how quickly it will grow.

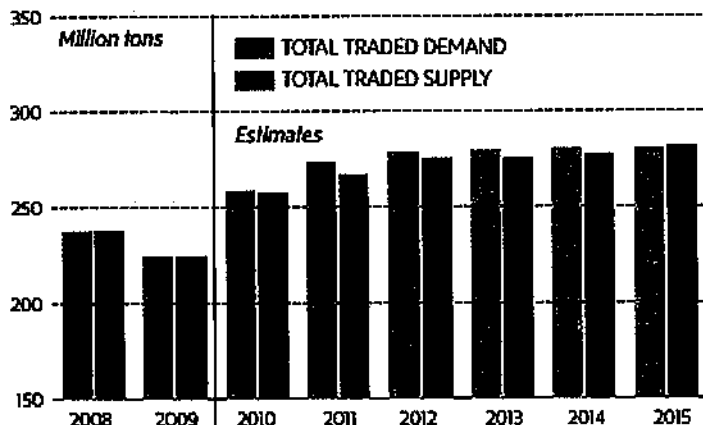
"I wouldn't call it a boomtown environment, but it's a healthy environment where there's a lot of good, solid long-term investment coming in," said Keith Calder, president and chief executive officer of fast-growing Western Coal, the main coal producer in the Tumbler Ridge area. "Morale is high. People are very positive - because what they're building is something that's a lot more permanent than what they saw in the past."

Tumbler Ridge is a microcosm of the booming market for Canadian coal, fuelled by accelerating demand from the still rapidly expanding economies of China and other major emerging markets, coupled with constrained supply flows out of some of the other leading global coal producers. With the outlook for coal looking bullish - not just for the coming quarters but also over the long term, as the global economy returns to expansion and the emerging economies continue their rapid modernization - Canada's coal producers are looking increasingly compelling as places to invest.

Analysts tracking the three main publicly traded Canadian coal miners - Western Coal WTN-T Teck Resources TCK.B-T and Grande Cache Coal GCE-T - are strongly positive on the stocks, with nearly 80 per cent of them rating them a "buy," according to data compiled by Bloomberg. On average, they see prices for the three stocks appreciating by more than 16 per cent over the next 12 months.

Contract prices for metallurgical coal (the kind used in steel manufacturing) in the industry's fiscal second quarter ended Sept. 30 were \$225 (U.S.) a tonne - a strong price at any time, but especially in a quarter that is typically a slow season for the coal business. The current quarter is looking almost as good, with contract prices already settled at \$209 a tonne; analysts believe the price could threaten \$250 in the first half of 2011.

The reason for the torrid pricing is Economics 101: There's not enough supply to meet demand.



THE GLOBE AND MAIL | SOURCE: UBS

Consumption this year has bounced back with a vengeance in the post-global-recession recovery, rising 16

per cent this year. UBS Securities this week forecast that world metallurgical coal demand will exceed production by as much as 6 million tonnes in the 2011-2012 fiscal year, a supply deficit equivalent to roughly 2 per cent of demand, as China continues to expand while demand from other key emerging markets, such as India and Brazil, picks up steam. Indeed, UBS sees the global metallurgical coal business in a supply deficit until 2015, as suppliers struggle to catch up to demand.

"We're of the opinion that the market is going to remain pretty tight," said analyst Mike Plaster of Saloman Partners in Vancouver. "It's not just demand. Supply out of Australia has been constrained, too."

Australia, the world's biggest metallurgical coal exporter, is having troubles keeping up with growing demand because its rail and port facilities are already at their capacity limits. That's being compounded right now as seasonal heavy rains have arrived earlier than usual, slowing shipments further.

" We have these strong prices and strong demand right now without the economies firing on all cylinders. When that comes back, we're going to see even more demand for our product. "- Keith Calder, Western Coal CEO

Canadian producers have run into some port constraints of their own, particularly out of Vancouver, where Westshore Terminals has been hit by some hiccups bringing some expanded capacity on-stream, but producers view the Westshore delays as temporary. Meanwhile, the Ridley Terminals coal facility at the northern B.C. port of Prince Rupert is running well below capacity, giving Canadian producers room to expand their shipments and fill the void to take advantage of Australia's shipping constraints and the favourable market conditions.

Analysts are most bullish on Western Coal, which has been expanding the most aggressively among the three publicly traded Canadian producers. It has almost doubled its production in the current fiscal year - it recently raised its production target for the year ending March 31, 2011, to 6.1 million tonnes compared with 3.2 million in fiscal 2010 - and Mr. Calder said the company plans to raise its totals to 8 million tonnes in fiscal 2012 and 10 million tonnes in fiscal 2013. (The company ships out of the Ridley facility.)

"I think we're going to see very strong met coal pricing over the next 24 to 36 months," Mr. Calder predicted. "We have these strong prices and strong demand right now without the [Western] economies firing on all cylinders. When that comes back, we're going to see even more demand for our product."

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