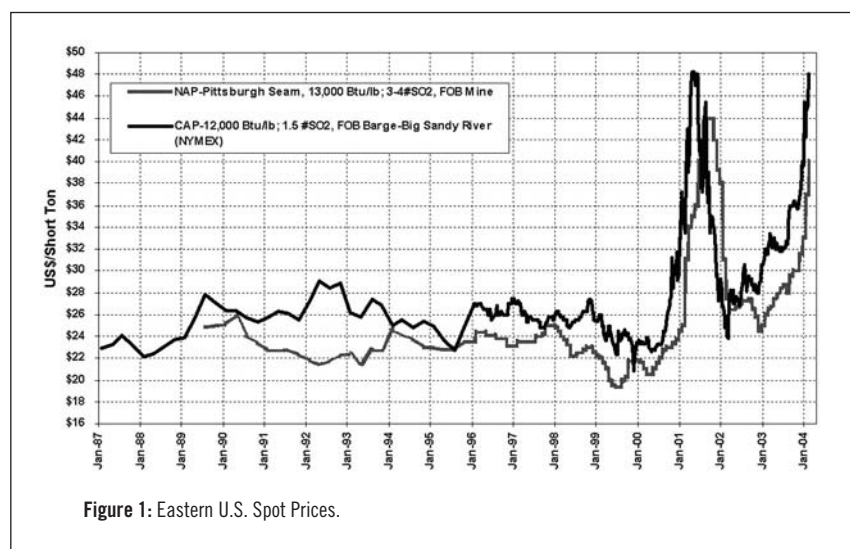


Not a Perfect Storm, But Not Bad

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Eastern bituminous coal pricing improved in the first half of 2003 but really took off in the 4th quarter (See Figure 1), as a result of three primary factors: strong global demand for metallurgical coal, high ocean freight, and a weaker U.S. dollar. The strong metallurgical coal market is due to China whose thriving domestic economy has reduced coal and coke available for exports and strengthened the world steel market. High ocean freight rates are being attributed to high oil prices and to increased Chinese demand for iron ore and strong Japanese demand for coal. The weakening of the U.S. dollar, particularly versus the Australian dollar, has made U.S. coals more competitive in Europe. The impact of higher freight and the weaker dollar on the net back pricing works in favor of U.S. coal producers.

These factors combined to provide an incentive to U.S. producers to shift production to the metallurgical market, both domestic and export. This is a reversal of a long-term trend to place metallurgical coals into steam coal markets. As these coals are switched away from the utility markets, demand for steam coals which can replace these metallurgical coals increased and put pressure on the steam coal market. The ripple effect has extended through Appalachia and the Rockies and to a limited extent, the Illinois Basin.

The market effect of these factors has been intensified by several other events which in and of themselves would not have caused this price spike. Most significant is PinnOak's Pinnacle mine which has been idle since September 2nd when a lightning strike damaged the ventila-

tion system. Pinnacle produces between 3 to 4 million tons per year (tpy), all of which moves as a low volatile metallurgical coal. Its loss in the market is not easy to replace.

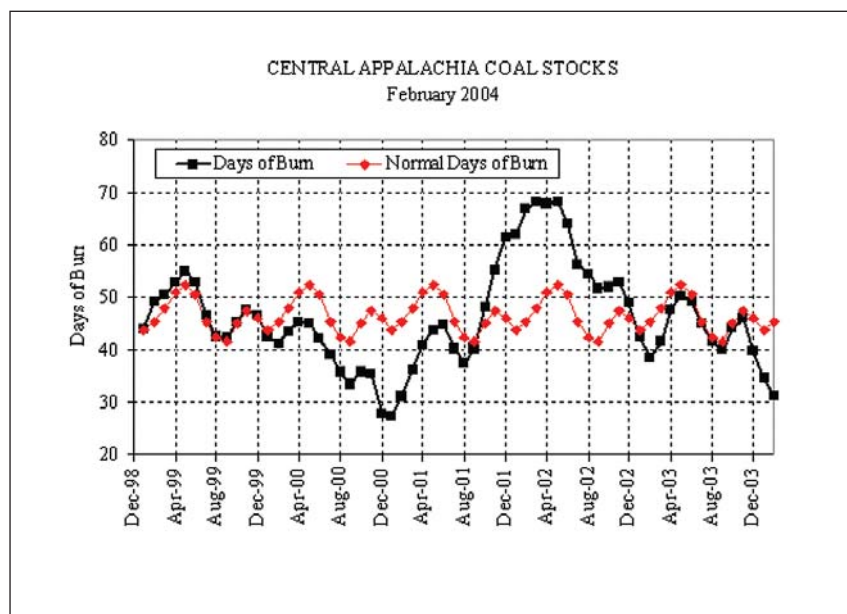
Also significant has been the other supply reductions in Appalachia which have occurred due to reserve depletion and bankruptcies. In Northern Appalachia, production in 2003 was more than 25 million tons below 1998 levels with a substantial reduction in the Pittsburgh seam production much of which can be attributed to depletion. Several Pittsburgh seam mines closed during this period including Dilworth, Humphrey, Mathies, and Quarto No. 4. In Central Appalachia, production in 2003 was

almost 50 million tons lower than 1998 production due to depletion and bankruptcies. Horizon Natural Resources, James River, Lodestar, Pen Coal, and Quaker all closed high cost mines as part of their bankruptcies. This production is not easily replaced due to limited reserve availability and permitting difficulties.

Incidents at individual mines have also placed pressure on the market. RAG's Cumberland mine and CONSOL's Buchanan mine have been idled. Massey lost some production at its Upper Big Branch mine. Thermal events at Alliance's Dotiki mine will affect production.

The tightness in the market resulted in a precipitous decline in stocks. By the end of February 2004, utility stockpiles of eastern coal were running way below normal. The low stockpile levels are exacerbating market conditions by forcing utilities into this high-priced market.

The market tightness is largely an eastern event with the exception of western bituminous coals which have experienced higher prices due to the easy substitutability of these coals for eastern coals. Colorado coal is even moving to New England. Two factors, though, are limiting penetration of western bituminous coals into eastern markets. There is not a lot of spare capacity available beyond current commitments to allow for a large increase in shipments east. Also, the Union Pacific is not performing with respect to its prior commitments which limits its ability to add new commitments to its plate.



Powder River Basin coal prompt quarter spot prices increased only modestly because of adequate capacity and limited displacement potential in the near-term. Producers continue to price Powder River Basin term and advance quarter offers at higher levels in anticipation of some market firming.

Producers have plans to add an aggregate of 31 million tons of capacity, which exceeds expected short-term increases in demand. Absent reduced production or higher than expected demand, prices for Powder River Basin coals will not follow the eastern coal price spike.

The duration of the eastern coal price spike is what may distinguish this market disturbance from the one that occurred in 2001 when prices rose and fell within a 12-month period. While prices may peak in the second quarter of 2004, the high price event is expected to continue through next year despite the fact that overall U.S. coal demand is expected to increase less than 30 million tons during this period.

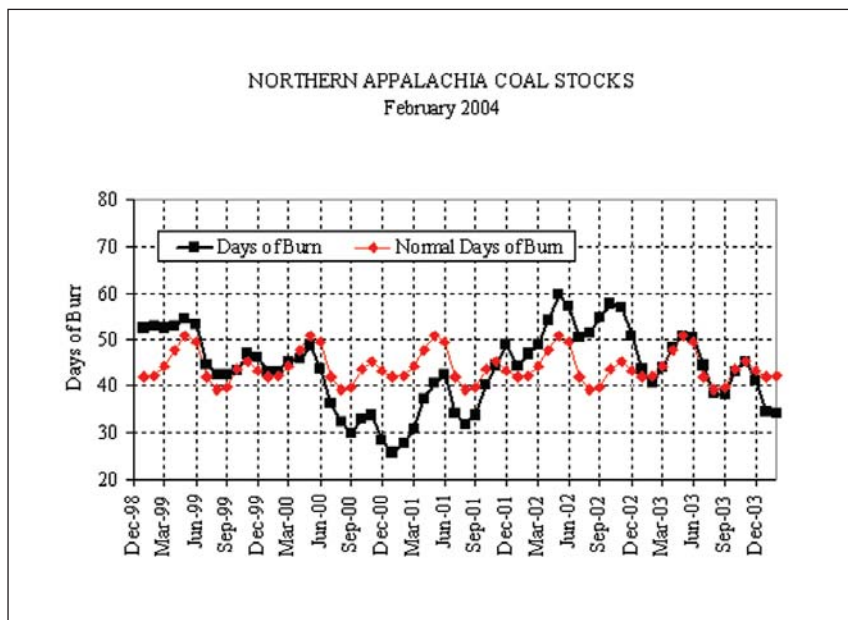
The delay is due to the limited ability for eastern producers to maintain, let alone expand their production levels, particularly in Central Appalachia, and the continued global metallurgical coal supply imbalance which will ultimately be resolved

through capacity expansions not in the U.S., but in Australia.

The factors that could cause an earlier return to more historic pricing levels are a reversal in the Australian/U.S. dollar exchange rate, which is not deemed likely given the large U.S. deficits; a reduction in ocean freight, which will soften vessel sup-

ply improves, and a quicker Australian response to the need for additional coking coals which is possible.

Prepared by Emily Medine and Seth Schwartz, both principals of Energy Ventures Analysis, Inc. (EVA), a consulting firm located in Arlington, Va. EVA recently published its annual COALCAST Short-Term Outlook for Coal and Competing Fuels.



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