

Energy Coal



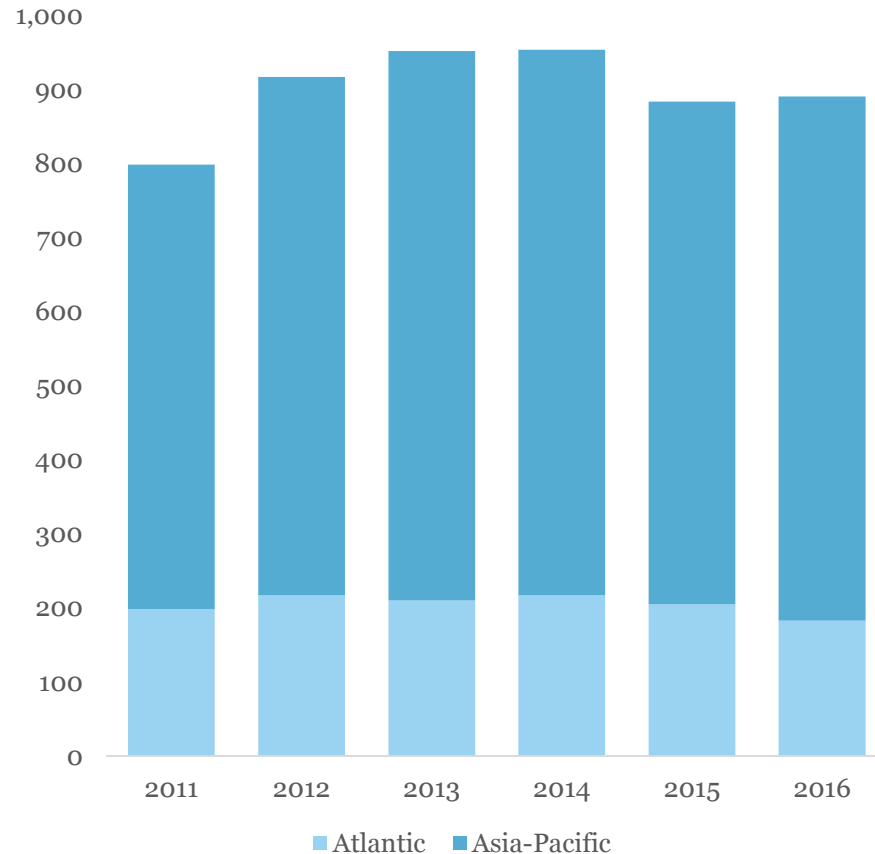
11 May 2017

Energy coal: dislocation from fundamentals

Size of the Asia Pacific market

Energy Coal – Market Volumes by Basin

(Million Tonnes)



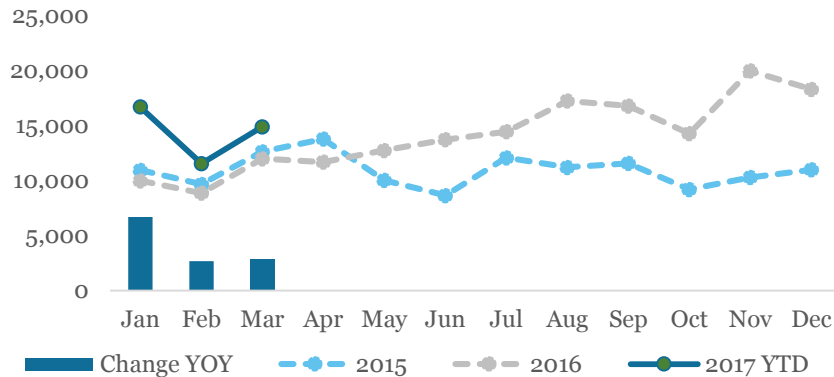
- The Asia-Pacific market is approximately 700 million tonnes
- Newcastle Energy Coal Price reference (NEWC) is used directly or indirectly to price approximately 70-75% of this market
- The use of this reference point for pricing has increased over the last decade
- Over the course of the last 6 months (however, mainly in the period January to March 2017) the ability to rely on this as a relevant reference point for commercial discussions has come into question
- The traditional relationship of this price curve with reference to other major markets; Atlantic Seaborne Market, China Domestic Market and Indonesian Domestic Market has broken down
- This has seen a dislocation from fundamentals and liquidity for traditional hedging reduce

The physical market remained strong in Q1 2017

Demand drivers – A healthy market

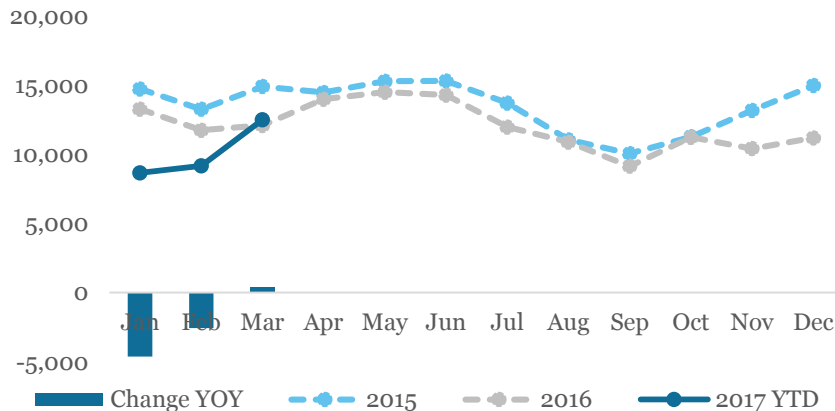
China Imports

(Thousand Tonnes)



India Imports

(Thousand Tonnes)



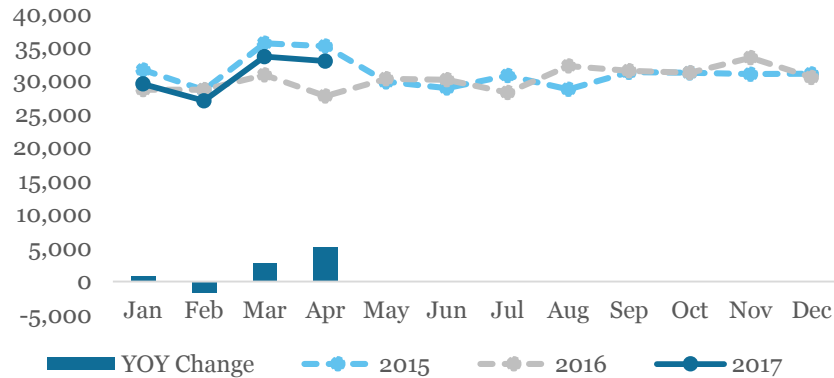
- Chinese thermal coal imports remained above 2016 levels, growing by 12.3 million tonnes (40%)
- India on the other hand remained weak in January and February, arising from the impact of demonetization in the coal market
- However, Indian imports rebounded in March as cash started to flow into the economy
- Overall, China more than offset the fall in India, with a combined growth of almost 6 million tonnes (8% YOY)
- Going forward we expect India to recover slightly, tracking 2016 levels
- Chinese imports will remain strong to the extent that domestic policy supports prices

The physical market remained strong in Q1 2017

Supply drivers – No supply response in Q1 2017

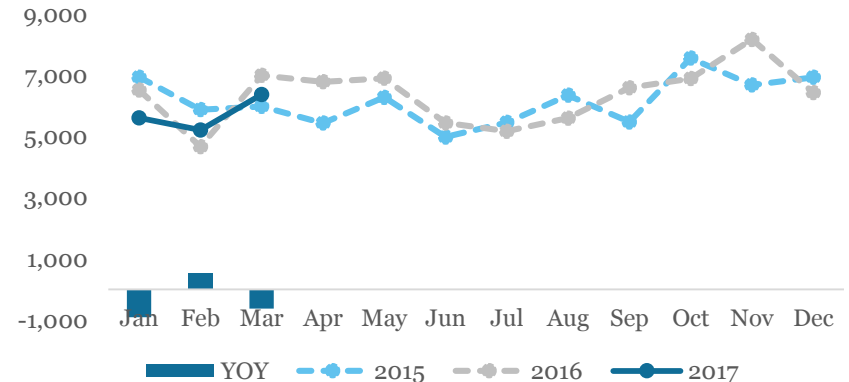
Indonesia Exports

(Thousand Tonnes)



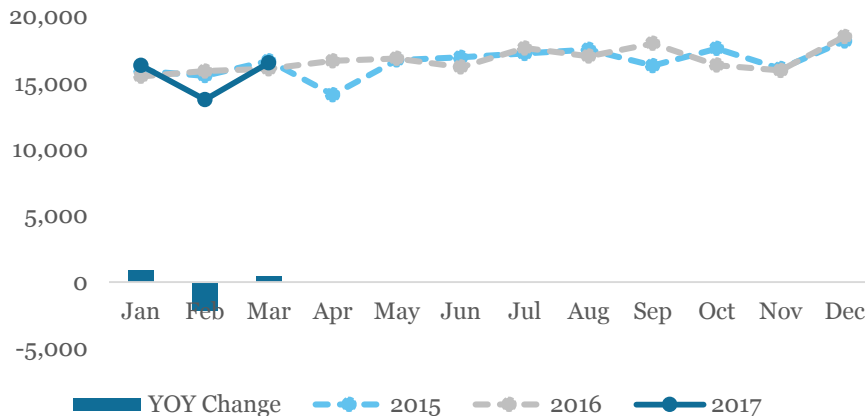
South Africa Exports

(Thousand Tonnes)



Australia Exports

(Thousand Tonnes)

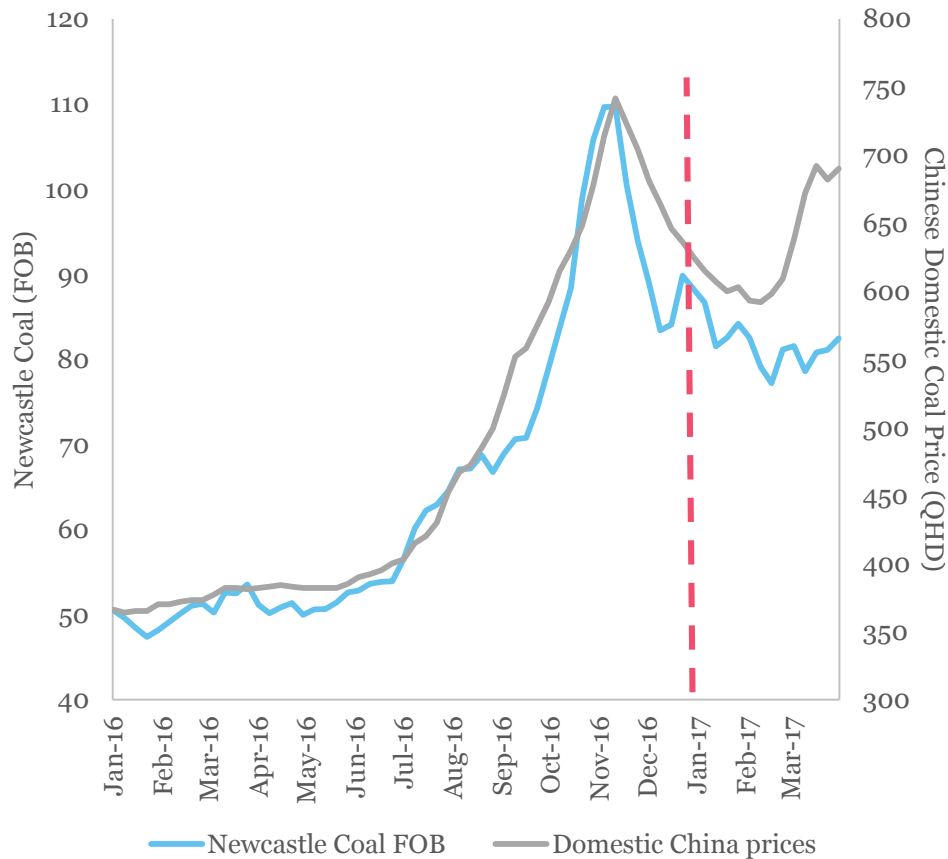


- Supply has remained relatively muted across the main coal exporting countries in the Pacific
- Indonesian production struggled amidst rain in excess of the seasonal average throughout the quarter
- The Indonesian domestic market grew by 5 million tonnes (20%), taking volumes away from the international market
- Australian exports fell by almost one million tonnes in Q1 2017 in spite of the international price recovery
- South African exports remain sluggish

Energy coal: dislocation from fundamentals

China and Newcastle price relationship

Energy Coal Prices – Seaborne and Domestic China



- The traditional correlation between NEWC and China domestic prices progressively eroded over the last quarter.
- Chinese domestic market has rallied by 16%, while Newcastle price action reduced by 13%.
- Over this period Chinese demand for imports increased by 12 million tonnes year-on-year.
- The procurement patterns and the basis of pricing specific types of coals is being reviewed by physical market participants

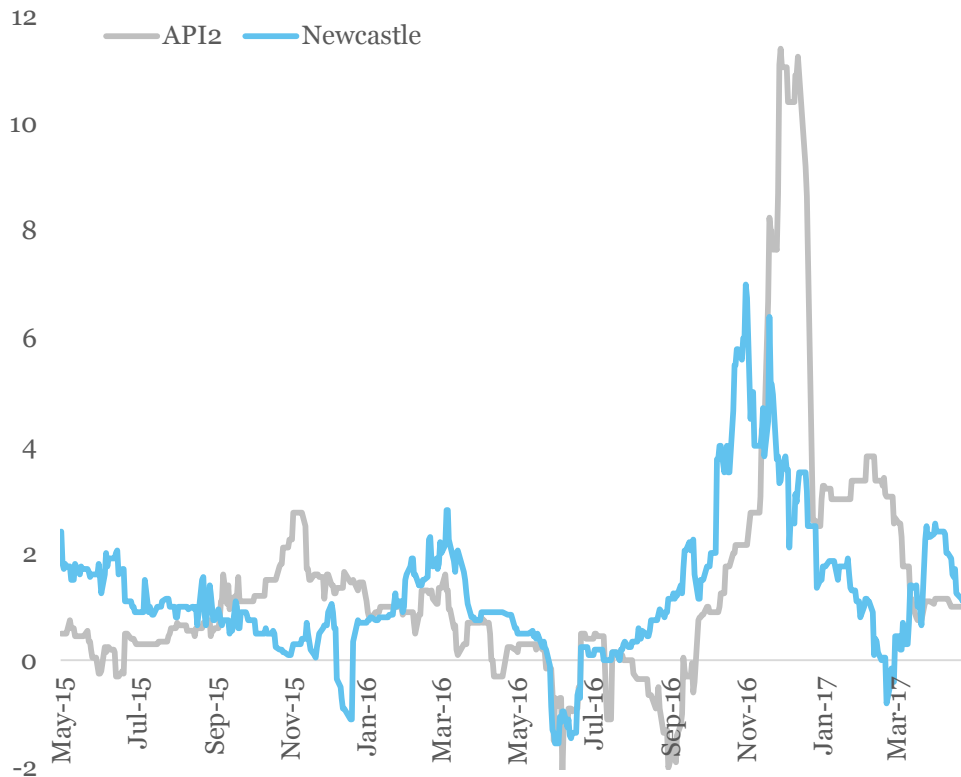
A disconnect from China

Energy coal: dislocation from fundamentals

Physical premiums/discounts

Coal Physical Premiums

(US\$/Tonne)

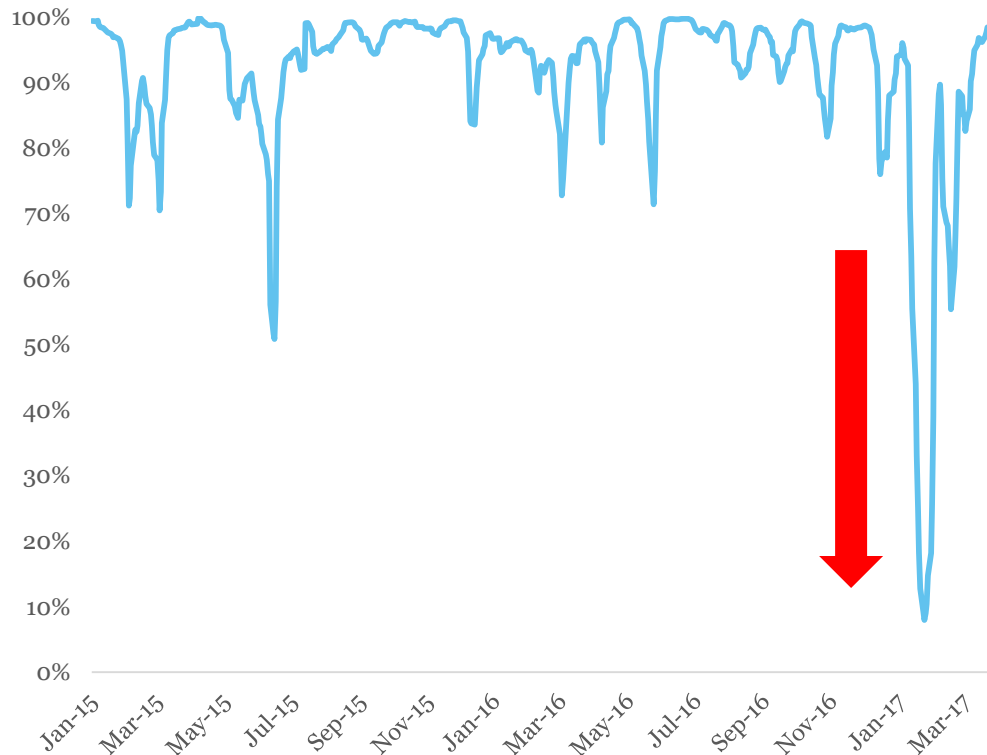


- Physical premiums changed radically in Q1 2017, as evidenced recently by the Japanese Reference Price settling at 10% to spot
- The Indonesian Government has advised they will revise the PLN price methodology due to the NEWC dislocation. This impacts 60mt of domestic coal burn
- Procurement in Asia is done quarterly along a rigid methodology. The price dislocation occurred month on month and developed through the quarter
- The disconnect between the Newcastle index and the physical market was also evident in the discount for Indonesian products
- The 4600 NAR Indonesian coal traded at a premium to Newcastle in Feb/March 2017 for the first time ever

Energy coal: dislocation from fundamentals driven by financials / hedge funds

European market and coal hedging activities

API2 / Newcastle Correlation



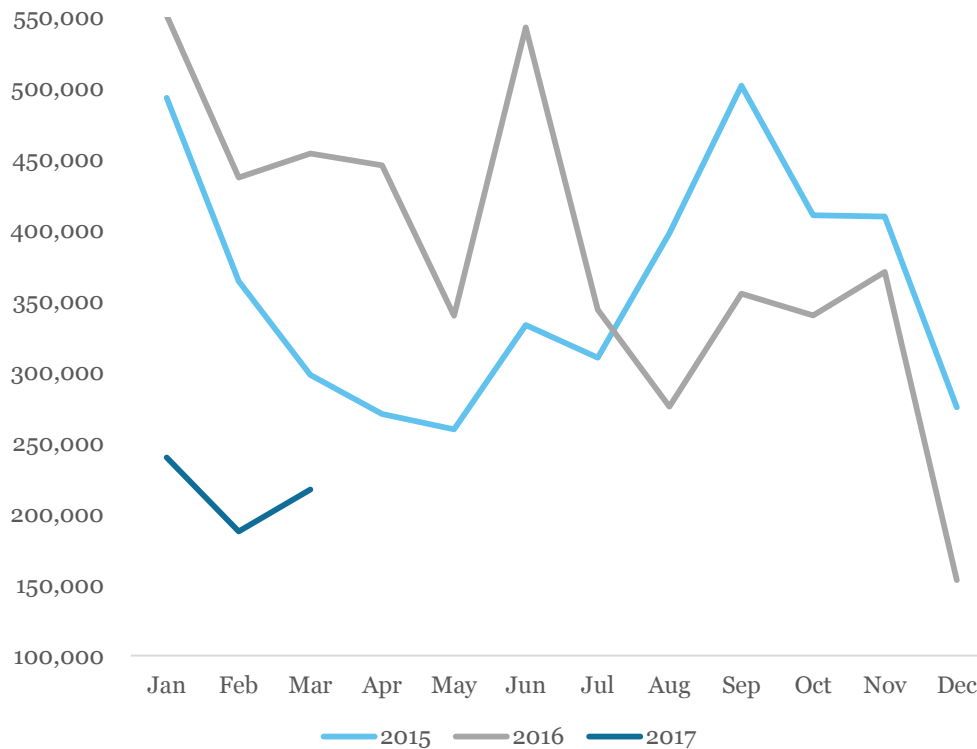
A disconnect from Europe and traditional hedging...

- The traditional correlation between the European Market and hedging activities (via API2) broke down completely
- While the NEWC index is used as a pricing reference point for the physical transaction of Energy Coal in Asia, in Europe, NEWC is used for financial participants to trade the relative value of API2 vs NEWC
- The introduction of new clearing platforms under which non-traditional market participants can enter (and transact via small 1,000 metric tonne lots) has increased volatility
- The Asian Energy Coal market of 700 million tonnes is being heavily influenced by small volumes of 1,000mt trades by financial participants, resulting in the physical participants reviewing the method of transaction
- The recent reference price agreement in Japan at a price of US\$84.97, which was approximately 10% above the NEWC reference price, illustrating the irrelevance of the “screen” to the “real” physical world

Energy coal: dislocation from fundamentals

Liquidity challenges

Exchange Cleared Coal Volumes - ICE, CME, SGX
(Lots)



- Exchange-cleared swaps liquidity fell to three year low in Q1 2017
- The Physical market has increased in this period
- Newcastle swaps' trading volume fell by nearly 40% between Q4 2016 and Q1 2017 and the trend continues

