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Coal could replace oil as fuel of choice

Abundant traditional energy source offers U.S. an option to foreign dependence

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Coal, the hard, black byproduct of fossilized plants used as fuel since China's Western Han dynasty 2,000 years ago, may overtake oil as the best performing energy investment.

That, at least, is the emerging consensus from a diversity of speculators, investors and giant corporations including Wilbur Ross, the billionaire bankruptcy specialist, BHP Billiton Plc, the world's largest mining company, and Merrill Lynch & Co., the third-largest U.S. securities firm.

Because "coal is the cheapest, most abundant energy source," from North America to China, "the surge in oil has encouraged people to plan new coal-fueled power plants and to start using conversion technologies such as coal-to-diesel," said Richard Price, an investment banker at Westminster Securities in St. Louis and a former vice-president at Peabody Energy Corp., the largest U.S. coal producer.

Converting coal into liquid fuel or natural gas becomes economical when oil remains above \$40 a barrel, said Stephen Leer, chief executive officer of Arch Coal Inc., the second-largest U.S. producer.

Oil more than doubled since January 2004, reaching a record \$78.40 a barrel on July 14 and averaging \$68 in New York this year. It hasn't traded below \$40 since June 2004.

Ross, chairman of International Coal Group Inc., is convinced the search for a cheaper alternative to oil and natural gas will enable coal to outperform oil. "The argument against it is not an economic one. It's about the environment and emissions."

Coal in the U.S. is forecast by analysts to recover from a drop this year caused mainly by a mild winter. Prices in Wyoming's Powder River Basin, the largest U.S. producing region, have fallen from a record \$21.50 a ton at the end of last year to \$11.50, according to data compiled by Bloomberg.

For the U.S. and China, the world's biggest energy users, coal offers the chance of reducing their reliance on Middle East oil that has tripled in cost since 2002. The U.S. has enough coal to last almost two centuries and today imports two-thirds of the oil it uses.

"A lot of the future energy requirements globally will have to be satisfied by coal," said Michael Schroder, head of resources at Old Mutual Asset Management in Cape Town, which manages the equivalent of \$55 billion, including shares in mining companies BHP Billiton and Anglo American Plc. "Coal seems to be on the agenda of lots of countries."

Using more coal is part of President George W. Bush's initiative to make the U.S. less dependent on imports. U.S. Defence Secretary Donald Rumsfeld in May authorized the Air Force, which burned 3.2 billion gallons of jet fuel last year, all refined from crude oil, to begin testing 100,000 gallons of a similar fuel derived from natural gas and coal.

South Africa's Sasol Ltd., which developed coal-to-liquids technology to reduce the nation's reliance on oil, has won the endorsement of the airline industry for a jet-fuel mix half derived from coal, and has sought approval for a 100-percent coal-based variety. The technology has helped turn Sasol into Africa's most profitable company and biggest by market value.

China, which has tripled oil imports in the last five years, has enough coal for a hundred years. Royal Dutch Shell Group Plc and Sasol are investing in plants in China with domestic coal companies.

Investors value coal reserves at a fraction of oil deposits. Peabody Energy's reserves are worth seven cents per million British thermal units, a measure of energy content, based on the company's market capitalization. At today's share price, Exxon Mobil Corp.'s oil deposits are worth \$3.16 a million British thermal units. That gap may narrow, raising the value of coal relative to oil, as more plants are built that allow coal to compete with oil. "Too much of a discount is being paid for coal equities at the moment given their inherent energy value and long-term ability to provide growing returns," said Kevin Bambrough, who helps manage \$3.8 billion Cdn at Sprott Asset Management Inc. in Toronto.

The recent slump in coal has depressed shares of producers. The Bloomberg U.S. Coal Index of eight companies has fallen 34 per cent since rising to a record of 810.55 on May 11. "That kind of a meltdown creates a lot of buying opportunities," said James Rollyson, a coal analyst.