Elizabeth Benvin, Market Analyst

Robin Goad, President and CEO of Fortune Minerals: Future of North American coal lies in export market

Fortune Minerals is a resource company focused on the development of high quality mineral resource projects in Canada. Fortune has three wholly-owned, advanced-stage projects including the NICO gold-cobalt-bismuth-copper deposit and the Sue-Dianne copper-silver gold deposit in the Northwest Territories, and the Mount Klappan anthracite coal project in British Colombia. The company declared a joint venture last year with South Korea's Pohang Iron and Steel for the development of its Mount Klappan deposit.

Asian Metal: Hello, and thank you for agreeing to do this interview with Asian Metal. First, many US coal consumers and producers have closed facilities or made cutbacks with mild winter weather and a growing market for natural gas for energy generation. Where is the US thermal coal industry likely to go over the next few years?

Robin: First, it is important to make the distinction that our coal is metallurgical and not thermal coal. But, I am happy to comment on the thermal market. Obviously mild weather in the U.S. northeast and Midwest has had a significant impact on energy consumption this winter. In addition, the other significant issue impacting the thermal coal industry is that natural gas is cheap. And with the discovery and additional potential for large production from shale gas in eastern North America, the price of natural gas is likely to remain low for the foreseeable future. This is having an impact on energy production in North America with a shift towards more natural gas power plants. Some of the new proposed nuclear plants are proceeding more slowly now because natural gas is a more cost-effective, short-term alternative.

Asian Metal: How about metallurgical coal in the US?

Robin: In the US, met coal is typically not quite as good of a quality as the Australian and Canadian coals. In the US, [met coal] is being sourced principally in the eastern part of the country, whereas in Canada it comes from the west, so I suspect that, due to the difference in quality and the cost of transportation, Canadian coal is probably more attractive to Asian buyers. Generally speaking, the higher quality metallurgical coal that was found in the U.S. Appalachians has been largely depleted and there is greater competition in the U.S. with other land uses that is making it more difficult to develop new open pit mines.

Asian Metal: What is the future for Canadian energy production and thermal coal?

Robin: Coal-fired power plants are most prevalent in the provinces of Alberta and Saskatchewan, although coal is responsible for about 20% of Ontario's electricity production. Ontario is trying to eliminate coal-fired power generation, but I expect this will not be possible. Other jurisdictions also have a moratorium on coal-fired power and there are new regulations that will impede development of new plants in many parts of Canada. However, the export market is good right now, particularly for projects located in British Columbia and Alberta that can service the emerging markets in the Pacific Rim. In addition, there is an old mine being re-opened in Nova Scotia. Consequently, we are not seeing cutbacks in production here in Canada; in fact we are seeing expansions. There are also several exploration projects in Saskatchewan with large amounts of thermal that have been identified. This coal is unlikely to be consumed in the Canadian market and because it is situated in the central part of the country far from ocean seaports, it is not likely to be developed in the near-term, but may make good coal gasification and liquefaction development opportunities.

Asian Metal: Do you think the recent joint ventures between Asian and Canadian enterprises, which seems to be the driving force behind the recent boom in the Canadian natural resource sectors, will gear the Canadian coal market primarily towards exports?

Robin: As far as Canadian companies finding success partnering with Asian enterprises, clearly there is growth in demand coming from Asia. China continues to be growing anywhere from 7-10%. India is planning to quadruple their crude steel production over the next decade, and Brazil, which is also an emerging market, is planning to quadruple crude steel production over the next 20 years. Indonesia, Vietnam and the Philippines are also experiencing significant growth that requires access to energy and steel. In addition, China is not just experiencing significant economic growth that requires increasing amounts to steel for infrastructure and consumer goods, but there is also good evidence that China is approaching peak production of coal. Almost all of their production is coming from underground mines and they have been closing down smaller, inefficient and unsafe mines that also do not comply with environmental regulations. There is clear evidence that the growth of coal production in China is starting to slow. This is being reflected by the dramatic, almost exponential increase in Chinese coal imports. Steel producers in Asia are conducting backward integration transactions in order to ensure security of supply. There is also significant innovation taking place in the coal industry where steel producers are developing new technologies to become more efficient, reduce greenhouse gas emissions and diversify their sources of raw materials. U.S. steel for example is using a new process that uses anthracite briquettes instead of hard coking coal, and POSCO is using a similar technology which they call FINEX, and other there are a number of other different technologies like Hi-Smelt, for example. The scarcity of supply is making vertical integration and joint ventures with Canadian producers attractive. I think we are going to continue to see these kinds of transactions as a result of strategic acquisitions by Asian companies and their sovereign banks.

Asian Metal: So with the expansion and the expectation that Canada will be consuming more energy, where do you think the future for both met and thermal coal in Canada lie?

Robin: The simple answer to this question is that the development of coal resources in Canada will continue principally for an export market. With respect to metallurgical coal, our steel industry is situated in eastern Canada and our coal production is in western Canada. So it might surprise you to hear that most of the coal that services the Canadian steel industry comes from the U.S. This is primarily a result of lower transportation costs to service the eastern North American market. Canadian metallurgical coal, which is produced in British Columbia and Alberta, is exported – virtually all over the world. If we take Canada's largest producer, which is Teck, their 23 million tons of annual production is shipped to Europe, Brazil, and all over Asia. That is just a function of it being close to the Pacific coast with access to inexpensive ocean shipping. Current Canadian metallurgical coal production is principally hard coking coal and PCI, but Fortune Minerals' project is anthracite metallurgical coal and is used in diverse steel and metallurgical process applications. Thermal coal is a different issue because of political policies in Canada, which limit the amount of coal consumed in power generation. There are only certain jurisdictions in Canada which have coal-fired power generation and these plants are fuelled under long-term contracts or from dedicated coal deposits. Governments here have been pursuing policies to try to eliminate or reduce coal-fired power and replacing this power with so-called green power initiatives, which are very high cost and are not capable of satisfying base load demand. There is some pushback happening right now on these higher cost green initiatives such as windmills and solar for which we are paying enormous subsidies to support power that is not commercially competitive. To summarize the answer to your question, I do not think that there is a lot of opportunity for marketing thermal coal in Canada, although new projects are being developed in western Canada for the export market.

Asian Metal: What challenges might Canadian companies be facing over the next few years?

Robin: Well the environmental permitting process is becoming more and more onerous all the time. But I think that the governments here in Canada have finally come to the recognition that the challenges of permitting new mines have probably gone too far. We are starting to see some indications that the governments at all levels are trying to streamline the permitting process. There is certainly recognition that it takes a very long time to navigate the permitting process and it is very expensive for smaller companies in particular. First Nations is also a difficult and complicated issue here in Canada. But developers enter into impacts and benefits agreements with First Nations so they will benefit from resource development in their traditional territories. Certain jurisdictions like British Colombia did not settle land claims with First Nations historically, and they are now dealing with the issue by splitting revenues with First Nations. Infrastructure is also an issue in certain parts of our country, and certainly one that is impacting our Mount Klappan project because we need to extend and also upgrade existing railway infrastructure in order to get our product out to the port. Also, many parts of Canada are remote and require new infrastructure in order to develop resources that are located there. The resources that are easily accessible are being depleted, so companies are looking for areas that are not as well developed, or are found in deeper deposits that need to be developed through underground mining operations.

Asian Metal: In your opinion, what role will the slowing of the Chinese economy, which has been lowered to 7.5%, play in the development of the Canadian coal market?

Robin: Well first of all, 7.5% is phenomenal growth. I think almost everybody agrees that there will not be a hard landing. In addition, the current 7.5% growth is the rate compared to the current size of their economy and in real terms is still very significant relative to the growth that has already taken place. In addition, the urbanization trends in China suggest that we are still at a very early stage in comparison to known templates in Korea and Japan. There is still going to be a large portion of the Chinese population that will migrate into cities that will need to be built and serviced by infrastructure. I have heard figures that [approximately] 20 Vancouver-sized cities will need to be built just to deal with the growth over the next decade.

Asian Metal: US metallurgical coal producers have been cutting production facilities and mines. Do you think that this is a trend that is likely to keep or do you think that the US, in particular, is going to be able to turn that trend around and become geared toward the export market?

Robin: I would suggest that it is getting more difficult to develop mines in the US. I am not seeing the same kind of recognition that this as a problem by US regulators as we see in Canada and some other countries. Clearly the extraction industry is less important to the US economy than it is in Canada. In addition, I would say that some of the higher-quality resources have already been depleted in the U.S. and it is becoming increasingly difficult to develop new mines because of land use conflicts. I do not think that it is the same for thermal coal, which is abundant in the U.S. and because there are large deposits in the west where land use conflicts are less of an issue.

Asian Metal: How do you think that Fortune will be able to distinguish itself from other coal operations in Canada?

Robin: First, our coal is quite unique and a very versatile coal. It has diverse usage in pulverized coal injection and sinter products, blend coals for the manufacture of metallurgical coke and direct coke replacement products and also as a reductant in metallurgical processing and electric arc steel manufacturing. Electric arc steel manufacturing is something that is going to see tremendous growth in places such as China as they secure greater sources of scrap from a more developed economy. So, strategically, our coal is going to be uniquely placed to be able to service different kinds of markets. And there is also a significant shortage of anthracite coal for the foreseeable future because the principle producers historically have been China and Vietnam. China is increasing its imports and Vietnam is curtailing exports to preserve its own supplies for domestic use. Our deposit is the only known deposit of anthracite coal in Canada. United States anthracite production and a lot of European anthracite production is now largely depleted. So our coal fills a very unique niche in the market which I think is going to see only increasing demand.

Asian Metal: What are Fortune Minerals' plans for the next few years?

Robin: We are trying to secure financial partners so that we will have financial resources to develop our two projects.. Basically, we have a requirement for about one billion dollars in capital to develop these mines. We are trying to secure this through joint venture relationships with companies that need to consume the products that we will produce. The focus is on Asia, which is essentially our priority over the next year in addition to permitting. We hope to be in commercial production in 2014 for the metals asset, late 2014 or early 2015 for coal, and then we are going to start looking for expansion opportunities.

Asian Metal: Thank you for agreeing to do this interview with Asian Metal.

Robin: Thank you!