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Met Coal Still a Hot Commodity But Coal Regulatory Enforcement Resources Have Cooled

The Wall Street Journal reported this week that metallurgical coal (or "met" coal) remains a sought-after commodity despite the general malaise of the coal industry as a whole. Met coal is a higher-grade coal than the thermal coal used in power plants with a low sulfur content and strong coking properties, which is used in steelmaking. Australia is the world's leading producer with the United States in second place and China's steelmaking industry is one of the leading consumers. China has its own domestic met coal production capacity and, combined with its steelmaking industry, produces 50% of the word's met coal and steel. As a result, China's labor and industrial policies have an outsized influence on the price of met coal.

The WSJ reported that met coal hit an average price of $161 per ton in March, whereas thermal coal sold for only $53 per ton, a price that has not seen much movement for the past two years. Spot prices for met coal in the first half of 2017 largely have been driven by the effects of Cyclone Debbie, which closed four Australian rail networks and disrupted coal exports. Because of the disruptions, April spot prices for met coal exceeded $300 per ton, but are expected to return to more typical levels once the transportation problems are corrected. Nevertheless, the price movements have benefited U.S. met coal companies.

Corsa Coal Corporation in Canonsburg, Pennsylvania is gearing up to increase production of met coal. The company reported that its new Acosta Deep Mine in Somerset County, Pennsylvania will produce 400,000 tons per year of low volatile metallurgical coal once it is fully operational. This news accompanied sound financial results in the met coal space. The company reported a 22% increase in met coal sales volume in the first quarter of 2017, as compared to the fourth quarter of 2016, and a 176% increase in sales volume as compared to the first quarter of 2016. CEO George Dethlefsen reported that the "metallurgical coal market remains tight" and that the company expects 100% growth in 2017 met coal sales over 2016. The increased demand saw Corsa's year over year revenues increase 412% for the first quarter in its met coal division. Corsa also touted its exceptional safety performance with violation per inspection day rates less than half of the Mine Safety and Health Administration's ("MSHA") national average and a lost time accident frequency rate that is below the national average for coal mines.

Warrior Met Coal, Inc. in Brookwood, Alabama also reported strong sales of met coal with an average selling price of $235.87 per metric ton for the first quarter. Warrior arose in 2015 from the bankruptcy sale of mines owned by Walter Energy, Inc. Warrior made an initial public offering of its stock in April 2017. The stock has been trading in a $1 range since the IPO, but Morgan Stanley's research department recently initiated coverage on the

stock with an “Overweight” rating and set a $27 target, a 54% upside.

While the success of met coal and the opening of new underground met coal mines represents positive news in a mining segment suffering through a multi-year trend of shuttering mines and significant coal miner layoffs, there may be unforeseen safety-related consequences due to a weakened enforcement environment. Because of the decreased number underground coal mines, MSHA reallocated enforcement resources from coal to the metal/non-metal segment.

Under President Trump’s proposed budget, coal enforcement has its budget cut by $3 million, while the metal/non-metal division saw its budget increase by $3 million. In the budget projection, nearly 74% of MSHA personnel cuts would come from its coal enforcement personnel. Significantly fewer inspection hours are taking place in the coal industry in the 2017 fiscal year compared to 2016. One of the significant indications of a weakened coal enforcement environment was the gradual closure of the Pikeville, Kentucky MSHA coal office beginning in 2015. Pikeville was one of the largest MSHA coal enforcement offices in the country in terms of the number of inspectors and mandated inspections that it handled. The reduction of coal mines in the Appalachian region, however, motivated its closure.

Some inspector positions have been absorbed by other MSHA coal offices and some inspectors were absorbed into metal/nonmetal positions while others were cut entirely. Despite these closures, MSHA coal offices in Virginia and Pennsylvania remain open and likely will have jurisdiction over some of the new met coal mines. With the smaller footprint of MSHA’s coal inspection program in place today, the met coal mines poised to open may see inspections short of the mandated four per year for underground mines, and two per year for surface mines. Coal mine inspectors also will be traveling further distances from their assigned field offices. MSHA also may be forced to shift enforcement resources back towards coal, or increase compliance assistance programs if the current slate of inspectors cannot keep up with mandated inspections. MSHA inspections of the new coal operations will undoubtedly continue despite recent resource adjustments, but it remains to be seen if the citations and orders issued during these inspections will match the type and volume of issuances previously experienced by the coal industry.