PRESS COVERAGE

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Eskom-bound low-grade coal could soon face global demand

The construction of new thermal power stations in India might prompt an increase in the export of low-grade South African coal to fuel these new power stations, reports international credit insurer Coface.

“South Africa ranks fifth in the world as a hard-coal exporter, after the US, Australia, Indonesia and Russia,” states Coface risk analyst George Marais, who further mentions that South Africa exports its best coal and burns the poorer-quality coal in its own power stations, which are specifically designed to handle lower-calorific coal and higher ash contents.

“However, export demand for lower-quality coal might increase as India builds new thermal power stations along its western coastline,” he says.

This increase in demand for lower grades of coal coincides with Southern Africa’s additional 24-million tons of combined yearly capacity, which is being added to South Africa’s Richards Bay Coal Terminal and Mozambique’s Matola Coal Terminal.

“This means [South Africa’s State-owned power utility] Eskom may no longer be the only buyer of South African poorer-quality coal,” says Marais.

He explains that, in the past, coal producers wanting to sell coal to Eskom were committed to long-term contracts that, “at best, offered steady but unexciting profits”.

Marais adds that, theoretically, 80% of Eskom’s coal consumption is derived from these long-term contracts, while the remaining 20% is bought at spot market prices.

However, as Indian import demand grows and import prices for lower-grade coals start responding to the higher prices of oil and export coal, Eskom might have to pay market-determined export prices for its spot coal purchases, which could further affect electricity pricing to consumers, says Marais.

Important Role-Player

South Africa is a significant participant in the global coal markets, says Marais, adding, however, that it is not the biggest. China, the US and India are much larger producers and consumers of coal, while Australia, Indonesia, Russia and Colombia are larger exporters than South Africa.

"Yet, South Africa's coal industry is noteworthy in several respects. Firstly, it is a relatively low-cost producer – along with Indonesia and Colombia – and has the world's largest coal export terminal at Richards Bay. Secondly, South Africa is conveniently positioned between the Atlantic and Pacific coal markets," he points out.

"This gives South Africa the potential to be a swing producer with the ability to export competitively to either Europe or the East."

Marais adds that, because South Africa has substantial coal reserves, it could potentially expand its coal exports, generate much-needed export earnings, and reduce its negative trade balance and current account deficit.

He notes, however, that an increase in coal exports could also be challenging, owing to inadequate rail capacity to the coast, among other issues. This is due to a lack of planning and investment coordination between privately owned mines and the State in terms of rail infrastructure and port capacity, he says.

Weaknesses

Marais further points out that environmentalists in South Africa and abroad have criticised the World Bank's decision to approve a $3.75-billion loan to build the world's fourth- largest coal-fired power station – Medupi – in South Africa, as the plant will feed global demand for coal mining and production.

"Protesters are urging the bank to stop supporting the development of coal plants and other large emitters of greenhouse gas and polluting coal mining operations," he says, adding that Eskom is the biggest producer of carbon emissions in South Africa, having produced 228-million tons last year.

Opportunities

Meanwhile, petroleum major Sasol operates the only commercial coal-to-liquids (CTL) fuel production facility in the world.

The company's Secunda plant produces about 160 000 bbl/d of petroleum, as well as a range of petrochemical products, says Marais, who believes that the future of CTL fuel in South Africa and in the Southern Africa region is positive, given the area's considerable coal reserves, which are estimated to be between 28-billion tons and 33-billion tons.

Additional Challenges

South Africa's ruling party, the African National Congress (ANC), concluded at its national conference in 2012 that State intervention in selected mineral resources was required to accelerate the industrialisation of the country – a decision which Marais intimates could be a threat to the future of South Africa's coal export business.

As an alternative solution, he suggests imposing tax levies on coal exports, which would be sufficient to secure coal for Eskom as it seeks to power downstream businesses. "State intervention may extend to partial nationalisation of some assets, although the ANC seems to have excluded wholesale nationalisation."

Marais explains that South Africa currently produces no less than 95% of its electricity from coal-fired power stations. "That is the world's highest proportion, and it is a proportion that is unlikely to fall significantly any time soon, not at least until the first new nuclear power stations come on line," says Marais.

Moreover, he points out that South Africa has limited hydroelectric potential, which further emphasises that Eskom cannot delay the construction of new power stations if it wants to reduce load-shedding.

"Thermal power stations can be built faster than nuclear ones. Solar and wind power are expensive and only viable in areas remote from the national power grid, and South Africa cannot risk relying on imported power from countries to the north that have hydroelectricity potential.

"As a country, South Africa will remain essentially self-sufficient for its electricity, which means that coal can look forward to strongly growing domestic demand," posits Marais.

Exports Outlook

Meanwhile, Marais describes the South African mining sector as "unstable", owing to last year's labour unrest, wildcat strikes and "poorly orchestrated" wage negotiations.

He says this behaviour has highlighted South Africa as a country with a volatile mining labour force, as did the exposure of structural problems between unions and government.

Marais states that South African labour costs are generally considered to be too high, adding that this is largely based on poor productivity and insufficient automation, compared with other leading mining countries.

"One reason for South Africa being perceived as an attractive destination in the past was its low cost of labour," he says, adding that organised labour has subsequently become more demanding in terms of its remuneration expectations.

“The country now faces the challenge of semiskilled mining workers who are earning a higher base income than most university-educated graduates,” he explains.

Marais further points out that the increasing involvement of the State in the mining industry has become a global trend, adding that South Africa has been experiencing State involvement for years, with calls for nationalisation and further taxation of the industry.

“Even the more expensive and mining-friendly South American countries have increased their level of State intervention through the introduction of control over exports, licences and permits, as well as an increase in taxes and royalties,” he says.

“However, South America is forecast to have some of the highest projected mining investment over the next 20 years, as a region. It therefore seems that mining investment is not deterred by State intervention, but by prolonged uncertainty,” says Marais.

This is exacerbated by the fact that “the mining industry has been selected as the most prominent vehicle to deliver the South African government’s socioeconomic agenda, resulting in significantly higher socioeconomic expectations from miners and host communities”, he says.

“Combined with the challenge of sourcing funding for large capital projects, the hurdle for new investment quickly becomes impracticable,” warns Marais.