Moving Forward With a Price Index for Australian Coking Coal

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Several firms are now publishing and promoting coking coal price indexes. There are big differences among the offerings, and these differences could be of long-lasting importance to Australian coking coal producers. Some might be more susceptible to manipulation by data providers; some require highly subjective calculation by the compilers and others might be largely driven by the sometimes swift and massive governmental policy shifts within China, as opposed to being driven by supply and demand in the broad, open market. For these reasons and more, we at Energy Publishing believe the Australian coking coal producers, as well as buyers and traders, should seize the initiative by settling on the index they feel is most likely to represent the market accurately over the long term and then take action to promote that index actively.

Selecting the Most Suitable Index

In order to choose the best index as the basis for trading Australian coals, it is necessary to consider the issues that are important to any index, as well as some that relate only to coking coal. The following discussion presents our view of those critical issues and summarizes the approaches used in the Energy Publishing CCQ© Index. Needless to say, we believe that index offers significant advantages over the others.

- **The location of the Price Reporting Point** – Some of the proposed indexes are based upon delivered prices into China or India. Many feel this is appropriate because so much of the spot trade is for coal moving into those two countries. However, others feel that an FOB Australia price is more representative of the broad seaborne market. Also, the Australia-based number is less subject to the governmental policy swings in China that can cause swift and massive changes in domestic production and in import tonnage and prices. We agree that Australia is the best spot to establish a reliable index; our index is based upon FOB Queensland premium hard coking coal prices.

- **What coal specifications to include when calculating the index** – Some of the proposed index approaches would base their index values on a range of specifications that include everything from the highest quality down to some coals that are only marginal coking products. Naturally there are wide variations in prices among these coals, and arriving at a fair and reliable index number becomes much more dependent upon manipulation of the data by the index compiler. Also, unwarranted variations in the index value can arise solely from shifts in the mix of products being traded from week to week – as opposed to a true shift in the market.

The Energy Publishing CCQ© index includes only premium quality hard coking coals. The full set of specifications is included in our Methodology. One important note is that only those coals with a CSR value equal to or greater than 68 are included. In that range, price relationships are predictable; below it, the discounts for lower grade coals can vary widely.

- **Frequency of Reporting** – The initial proposals for the frequency of index re-calculation ranged from daily to quarterly. The quarterly report proposal seems so infrequent as to be more or less useless to an active trading market. On the other hand there are many days, or sometimes even weeks, that go by with no trading activity. So, reporting on a daily basis is problematic. One compiler is issuing daily prices, sometimes reportedly based upon changes in steel or iron ore prices.

  Energy Publishing is currently re-calculating the index once per week. As of September 13, 2010, we will begin publishing the index value daily along with comments on daily events and any new trades in our Inside Coal newsletter. In most weeks, the day-to-day index value will probably not change, but if there are obvious major changes in the market during a given week, we will update the index mid-week as appropriate.

- **Liquidity** - For any index, more liquidity is highly desirable. If there is more trading activity, it will be possible to include more trades in the index calculations and reduce the chances of outliers moving the market. One of the proposed indexes covers as much as 85 million tons of production; but that index includes an unworkable variety of coals. Energy Publishing's CCQ© index covers about 40 million tons of Australian production. Traders we have talked with who work in numerous commodity products consider that number to be more than adequate. In addition, the inclusion of the premium Canadian coals, which sell into the same northern Asian markets at the same price as the Australian coals, adds an estimated 5 to 10 million additional tons. (Because of high CSR values and ocean freights within $2.00 of those out of Gladstone, the better Canadian coking coals have recently achieved price parity with premium Australian coals.)

- **Qualifications of Index Compilers** – For any index, it is essential that the data be gathered and the index calculated by qualified and experienced personnel. This is particularly true for coking coal because the personnel collecting trade data must understand differences in coal qualities and must be experienced enough to ask the questions needed to get the true terms and freight arrangements of a deal that seems suspicious. Junior staffers who might be in the job for only one or two years before they move on are not likely to have had the time needed to develop the necessary understanding and instincts. Energy Publishing, on the other hand, has tasked its senior staff with gathering the coking coal trade data and calculating the index. Each of these senior people has many years of experience in the coking coal industry experience.

  In addition to our own experienced senior staff, we have the help of a blue-chip panel of advisors in dealing with issues that arise periodically from changes in the marketplace.

  Energy Publishing as a firm also has considerable experience in producing indexes, all for coal. The NEX Index is the continuation of the BJI Index which has been prepared by our Brisbane office for many years, and widely used in contracts for Pacific Rim coals. Likewise, the South African Steam Coal Index has a long history and was part of the API4 Index until a change in ownership. In the U.S., we have published several indexes for steam coal for more than 10 years.

We believe that our CCQ© Index is based upon a solid approach to each of these critical issues. What we need now is for those producers, buyers and traders who agree to help promote this index and get the market started.

How to Kick-start the Index of Choice

What might the market participants do to promote the best index? We see three major options, namely:

1. Begin writing contracts with price adjustments based on the chosen index.

2. Begin providing future quarter buy/sell prices based on the index of choice to the banks that are interested in becoming market makers for the paper market.

3. Support screen trading based on the index of choice.

Of course, writing contracts with index-based pricing requires both buyer and seller to agree to the idea. However, it seems likely that many buyers in both India and China would be willing to give the idea a try if it were suggested by one of the large Australian producers. As soon as a few contracts are written on an index, it is likely that listing on one of the exchanges will follow shortly

For a company that is active in the market, providing data to support the beginnings of a forward curve requires no more than sharing its feel for the near term market outlook with one or more of the interested banks. At least one is actively trying to promote a swaps market, and others are likely to follow quickly.

Global Coal is working to develop screen trading for coking coal and hopes to offer a standardized contract covering a few basic classes of premium coking coals. The trades can be based on the index of choice, so long as the counter-party agrees.

If just a few companies step up to the plate and undertake one of these options, it is likely the market will develop fairly soon thereafter.

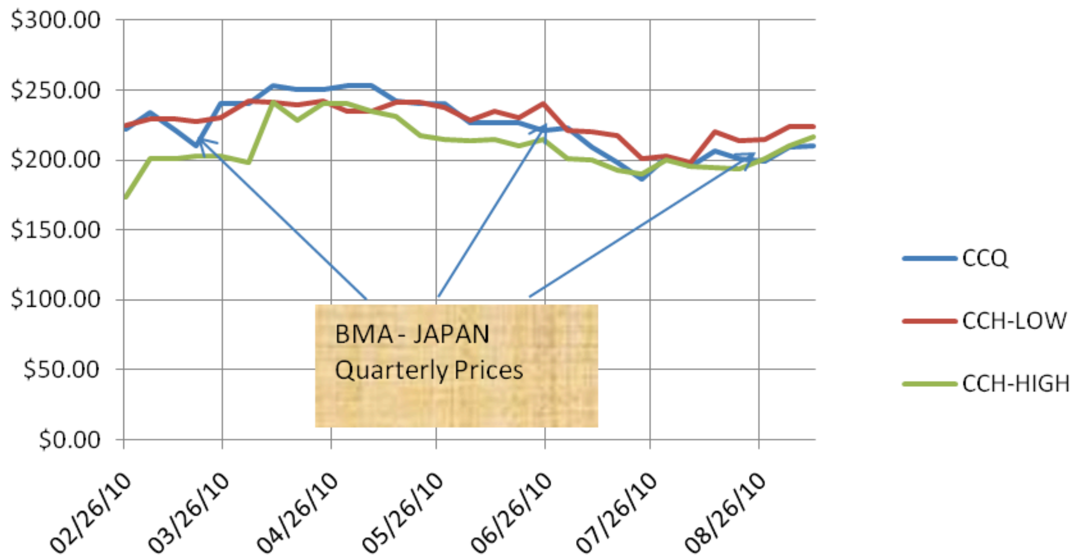
Methodology and Specifications for Our Indexes

The methodology used to calculate Energy Publishing's indexes and the specifications for the coals to be considered when calculating the index are available on the internet in two places: 1) at Coalportal.com and 2) on our website at Energypublishing.biz.

Graph of the Index Values

A graph of the values for the three indexes prepared by Energy Publishing is attached.

Energy Publishing Coking Coal Spot Price Index Values



CCQ = FOB Queensland, Premium Hard Coking Coal
CCH-LOW = FOB Hampton Roads, Premium Low Vol Hard Coking Coal
CCH-HIGH = FOB Hampton Roads, Premium Type A High Vol Hard Coking Coal