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Coal Turns Ugly as Gas Cuts Use to 20-Year Low: Energy Markets 2012-02-17 05:23:08.930 GMT

By Mario Parker

Feb. 17 (Bloomberg) -- Coal demand in the U.S. is collapsing as power companies switch away from the fossil fuel to take advantage of the cheapest natural gas in 10 years.

Use of coal to generate electricity will drop 2 percent this year to the lowest since 1992, while gas-fired consumption rises 5.6 percent, according to the Energy Department. Gas prices have tumbled to the weakest levels since February 2002 this year amid a boom in output and milder-than-normal weather.

Appalachian coal, the U.S. benchmark grade, sank 15 percent in January and is down 26 percent from a 2011 high, prompting companies from Alpha Natural Resources Inc. to Patriot Coal Corp. and Arch Coal Inc. to close mines. Natural gas has dropped 35 percent in the past year as higher-than-average temperatures cut demand and hydraulic fracturing, or fracking, at shale formations drove inventories to record highs.

"It's very ugly," J. Christopher Haberlin, a Richmond, Virginia-based analyst at Davenport & Co., an investment brokerage, said by phone on Feb. 15. "Gas is a major driver and the oversupply there has been well documented, but adding to the pain is the unseasonably mild winter we're having."

Coal has dropped 15 percent to \$58.95 a ton this year on the New York Mercantile Exchange and is close to a two-year low.

Natural gas for March delivery fell 1.2 percent today to \$2.537 per million British thermal units.

Gas costs for power plants dropped to the equivalent of 94.4 cents per million Btu below coal on Feb. 16 and plunged to \$1.16 on Jan. 19, the biggest discount since coal futures began trading in 2001, according to futures prices and data compiled by Bloomberg News.

Declining Demand

Arch, the second-largest U.S. producer, said Feb. 10 that coal used to generate power may drop by at least 50 million tons this year. The company is reducing output at the Dugout Canyon mine in Utah in the first half of the year.

Patriot said this month that it will shut its Big Mountain complex in West Virginia, which produced 1.8 million tons of coal last year. Alpha plans to idle six operations between February and early 2013, it said this month, and will alter work schedules and cut production crews at some of its other mines, citing weak demand.

Spokesmen for Arch, Alpha and Patriot didn't return telephone messages left yesterday for comment.

Total coal consumption for the week ended Feb. 9 was down 20 percent from a year earlier, according to Genscape Inc., a Louisville, Kentucky-based data provider, which monitors coal use by power producers with devices installed at the plants.

Utility Stockpiles

Utilities may have about 168.4 million tons of coal in inventory at the end of this year, the lowest level since 2008, Energy Department data show.

Gas production in the lower 48 U.S. states rose 1.3 percent in November to a record 72.61 billion cubic feet a day, driven by gains in states that contain shale reserves, the Energy Department said Jan. 30 in its monthly EIA-914 report. Supplies for the week ended Feb. 10, were about 38 percent above the five-year average.

The average temperature in the contiguous U.S. for January was 36.3 degrees Fahrenheit (2.4 degrees Celsius) or 5.5 degrees above the 1901-2000 average, making it the warmest January since 2006 and the fourth-warmest on record, according to the National Oceanic and Atmospheric Administration, curbing demand for heating fuels.

Utilities and electricity transmission organizations that have both coal and gas plants in their portfolios are relying more on the cheaper fuel to produce power, said Christopher Peterson, lead industry economist for the Office of Energy Statistics at the Energy Information Administration, a unit of U.S. Energy Department.

Power Generation

Coal accounts for about 45 percent of electricity generation, while gas totals about 24 percent, Energy Department data show.

Use of coal for power generation will drop this year to 916.4 million tons, the smallest amount since 1992, according to the Energy Department. Gas-fired power production will increase 5.6 percent as electricity demand rises just 0.4 percent, the department said in an outlook report on Feb. 7.

"It's not the best-kept secret in the world that gas is hurting coal burn," Mike Dudas, an analyst at Sterne Agee & Leach Inc., a Birmingham, Alabama-based brokerage, said by phone on Feb. 15. "One thing that's not going to help coal is 40-degree weather in Chicago in February."

Coal is unlikely to receive a boost from foreign demand as it did last year as economies in Europe struggle to stave off a recession amid rising debt, Haberlin said. Exports are expected to fall 8.7 percent to 97.6 million tons this year from 107 million in 2011, which was the highest level since 1991, according to Energy Department data.

Foreign Sales

Europe was the largest buyer of U.S. coal last year through September, accounting for about 50 percent of exports, according to the most recent data from the Energy Department. The region's economy shrank 0.3 percent in the fourth quarter from the prior three months, the first contraction since the second quarter of 2009, the European Union's statistic office in Luxembourg said Feb. 16.

"The one real window of support has closed," Lucas Pipes, an analyst at Brean Murray Carret & Co. in New York, said in a phone interview. "You're really not making money selling thermal coal right now."

Utilities are also switching to gas from coal because of an impending government rule that calls for Texas and 26 eastern states to cap sulfur dioxide to limit acid rain and soot.

Shutting Down

The rule, combined with the declines in gas prices, may force utilities to close about 12 percent of the nation's coal-fired generating capacity, according to IHS CERA, an Englewood, Colorado-based provider of energy data.

American Electric Power Co. and Southern Co. are among power producers that plan to boost gas-fired output at the expense of coal. Dominion Resources Inc. said Jan. 27 that it would convert three of its coal units to burn wood.

Mining costs to dig thermal coal out of the ground range from \$65 to \$75 a ton for a Central Appalachian coal producer, Levin said, as much as 27 percent more expensive than the current price.

“It’s very difficult for a producer of steam coal to make money in this environment,” Levin said. “There simply isn’t demand for utility coal. Why would you continue to run?”

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