Evolution of U.S. Coal Producers through 2018

16th Coaltrans USA

Miami, FL

January 28, 2016

DTC

About Doyle Trading Consultants

We give our clients an edge by providing the following:

- ✓ **Daily**: DTC's highly regarded daily market commentary and price recap (global & US coverage)
- ✓ **Weekly**: DTC's 'Week Ahead' email (previews key drivers and important data release dates)
- ✓ **Monthly**: A comprehensive summary and analysis of the major market drivers and price curves;
- ✓ **Monthly**: DTC's Supply & Demand Forecast; Utility Inventory Forecast (& commentary)
- ✓ **Intra-monthly**: Timely reports on global steel production, monthly export/import data (company specific), US generation & inventory data, etc.
- ✓ **Quarterly**: Company-specific mining costs, priced positions and earnings summaries; quarterly production data and analysis; changes in institutional ownership of coal equities
- ✓ **Much, much more**: DTC monitors natgas vs coal dispatch economics; seaborne coal negotiations; steam coal export break-even economics; etc.
- ✓ **Quarterly Coal Outlook and Price Forecast**: DTC launched its *Quarterly Outlook and Price Forecast* in April 2014.
- ✓ **Bespoke Consulting**: available upon request.

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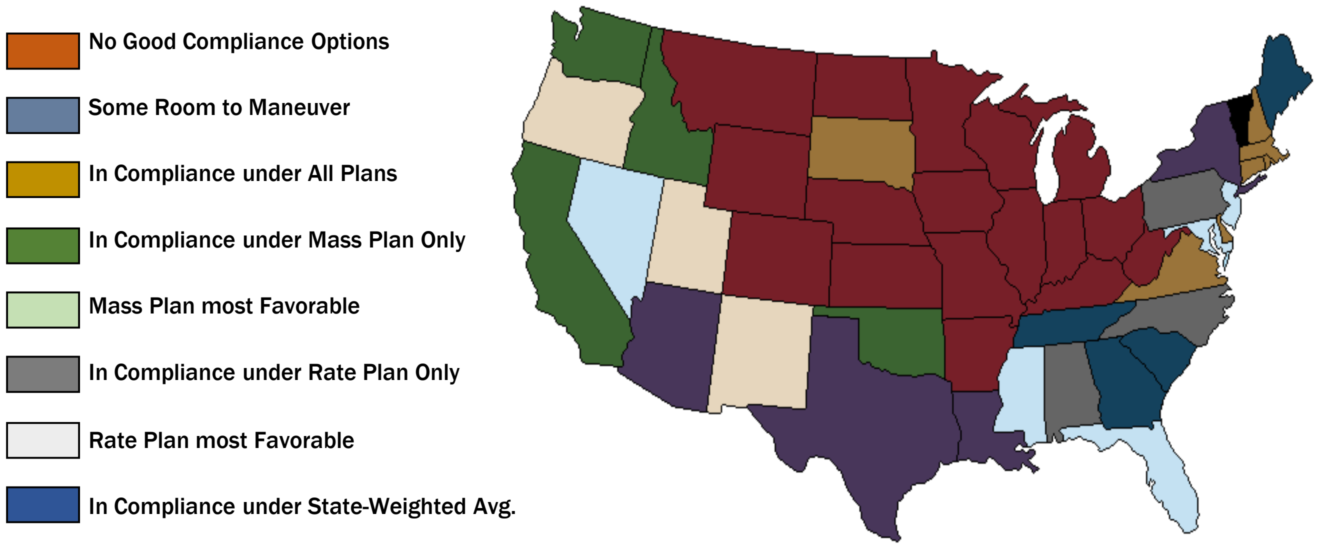
New DTC Report!

Clean Power Plan – Surviving a Regulatory Game Changer

- ✓Most comprehensive analysis on Clean Power Plan available
- ✓Identifies likely compliance path for each state, as well as surviving coal plants
- ✓Calculates impact on coal burn through 2030 under various compliance scenarios



Agenda

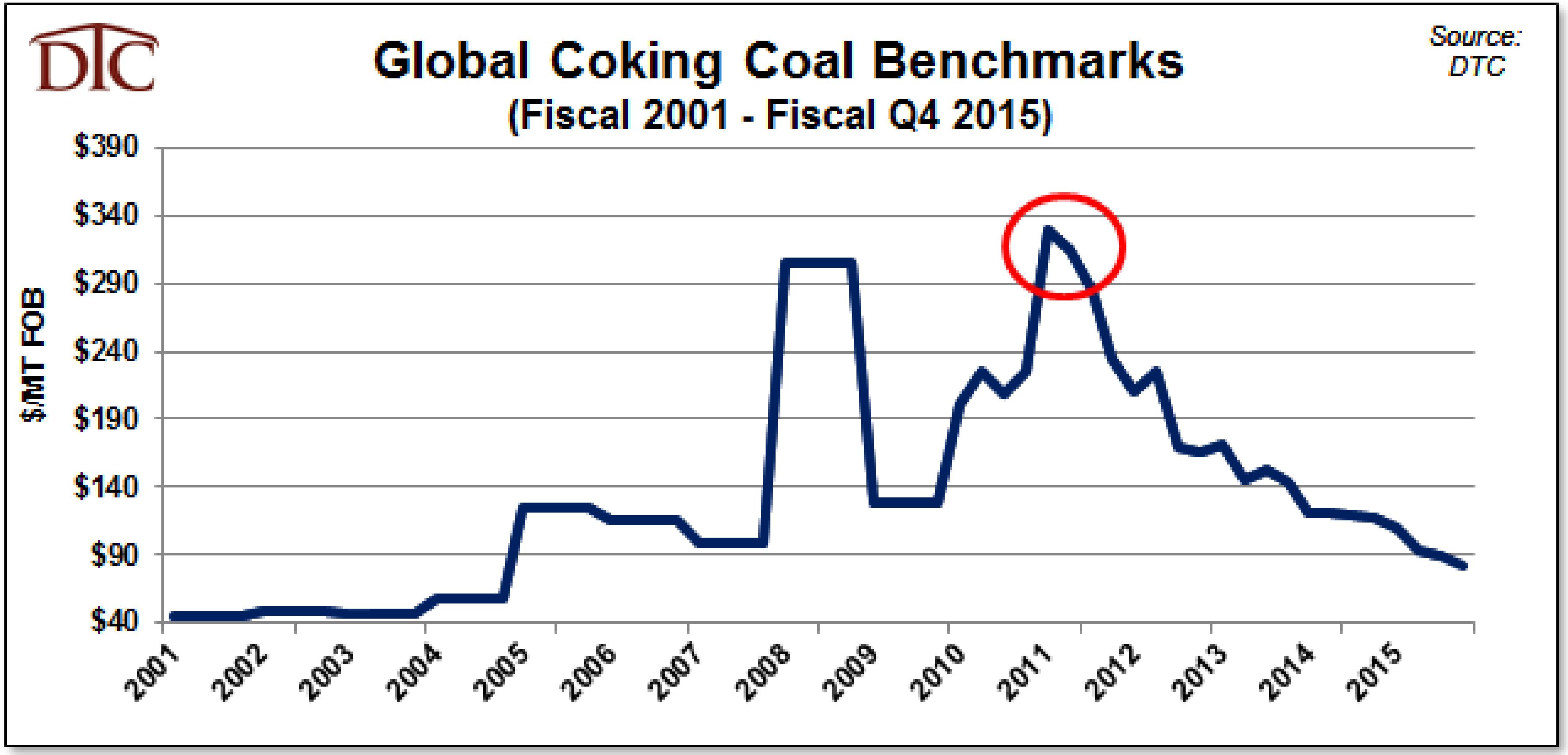
- Consolidation + Restructurings
  - Creating many opportunities
  - Steady M&A deal flow expected
  - Constructive consolidation?
- US coal market in 2018
  - Supply and demand forecast
  - Productivity by region
- Wrap up

Consolidation + Restructurings: the path forward

M&A Waves 1 and 2

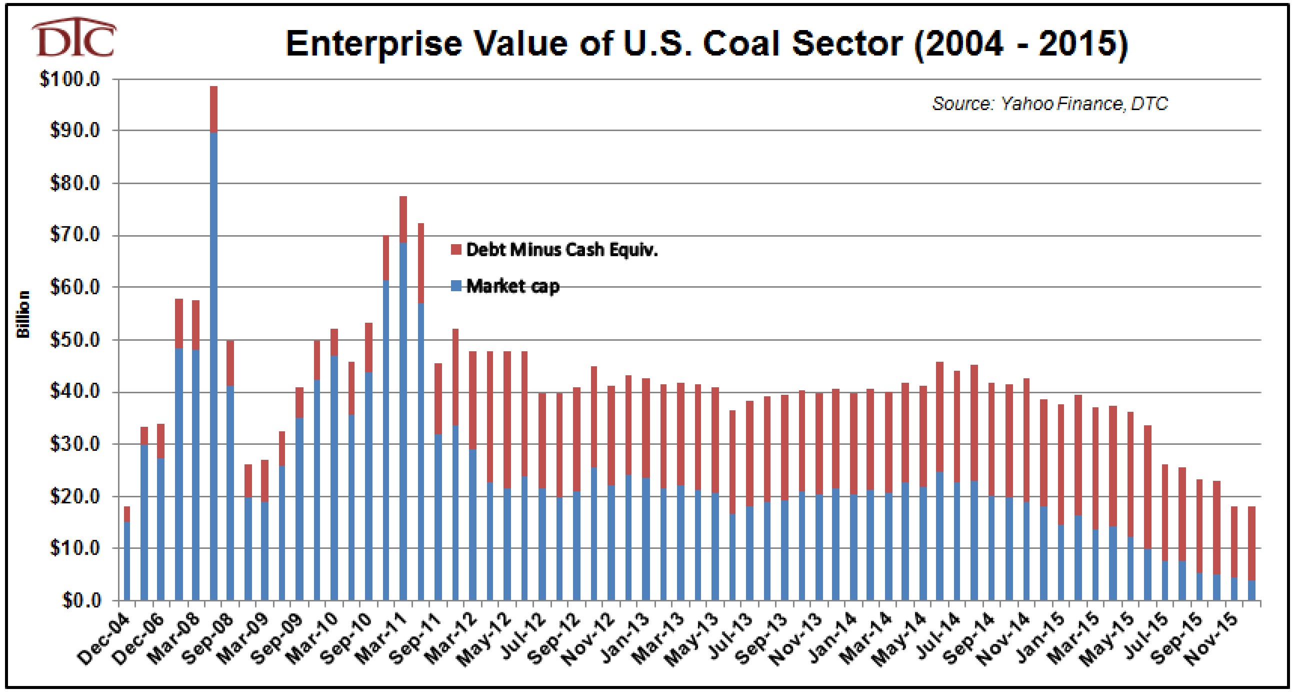
- **Wave 1: Global Steelcos Enter US Met Market (June '08 – Mar '10)**
  - ArcelorMittal/Midvol Mining and Concept Mining (June/July of 2008); Severstal/PBS Coals (Oct 2008); Mechel/Bluestone (Feb 2009); Metinvest/United Coal (Apr 2009); Essar/Trinity (Mar 2010)
- **Wave 2: U.S. Producers Bet on Met (Dec '10 – Aug '11)**
  - Alpha/Massey (Dec 2010); Walter/Western (Jan 2011); Arch/Intl Coal Group (May 2011); Peabody/Macarthur Coal (Aug 2011)

Coking coal bets ill-timed



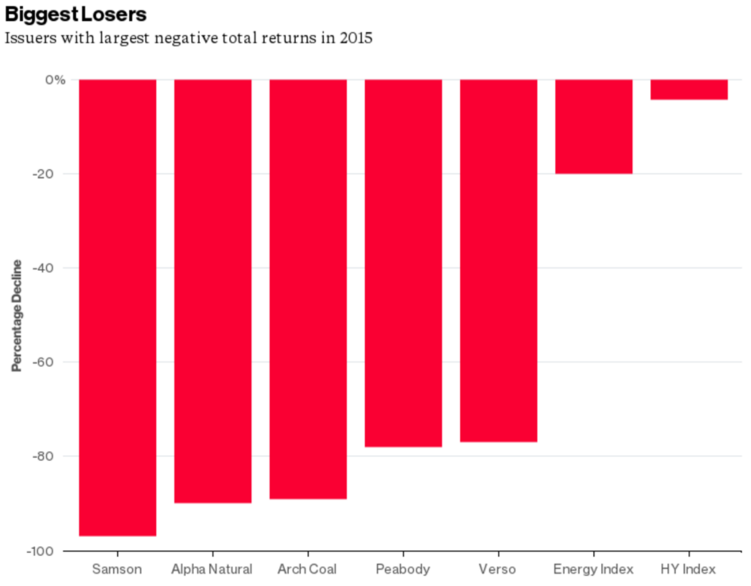
Debt was primary means to fund deals

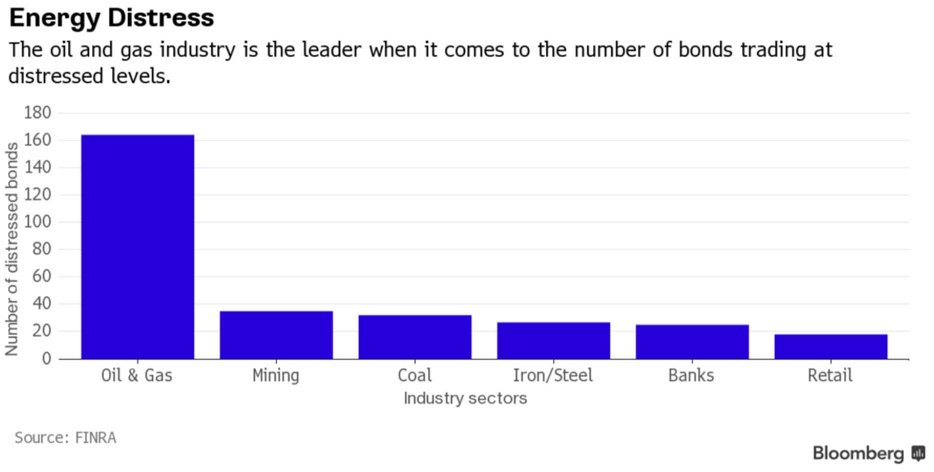
- Net debt surged from 10% of EV in March '10 to 44% by Dec '12 and 78% by Dec '15
- Easy access to capital made debt attractive, but interest payments drive irrational decisions
- Highly levered companies do not fare well in weak markets



'Amend and extend' no more

- Investors less willing to fund cash burn for future upside
- Ability to refinance much harder today than 12 months ago
- Bid for coal securities (debt and equity) has evaporated
- Distressed investors are licking wounds, eying oil and gas opportunities





Capital markets largely closed for coal

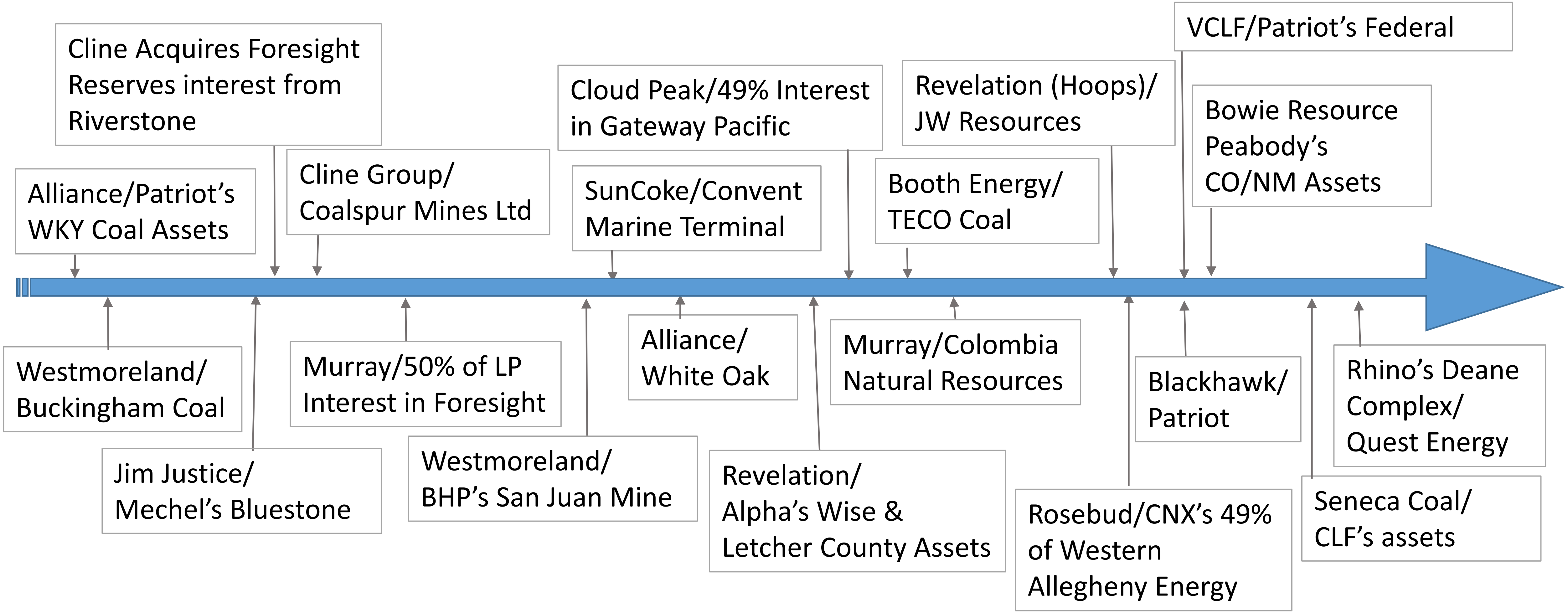
- Debt
  - Peabody Energy: priced $1 billion of senior secured second lien notes on March 16th 2015 at 10% coupon; currently trading at $18
  - Murray Energy: priced $1.3 billion of senior secured notes on April 10th at $96.86 with 11.25% coupon; currently trading at $17
  - Bowie?
- Equity
  - CNXC: down 56% from July '15 IPO
  - FELP: down 92% from June '14 IPO
  - Bowie Resources: received $313 mm in common/preferred equity from Blackstone in November 2015

PHOTO: SHUTTERSTOCK

Leverage + weak market – access to capital = restructurings

- Wave of bankruptcies, but unable to support market
  - Alpha: significant production cuts
  - Arch: limited impact on supply
  - Patriot: assets change hands
  - Walter: production cuts pending
- Fixing balance sheet, but not addressing the market
- Leaner companies post-reorg. hold advantages, pressuring rest of industry

M&A Wave 3: Bolt-On and Fire Sale Transactions



On the Sales Block

- **Every Coalco:** Non-core assets; export capacity; JVs
- **Bankruptcy Auctions**: Alpha, Walter
- **CONSOL**: Buchanan, Baltimore
- **Peabody**: anything but core assets (PRB, ILB, Australia?)
- **Assets with sales contracts**
- **Everything has a price!**

Potential Buyers

- **Coal King Pins**
- **Traders**
- **Private Equity**: Blackstone investment in Bowie
- **Consolidators?** Blackhawk, Bowie, Justice, Rosebud, Westmoreland, Alliance, Murray Energy, Revelation, Booth, Corsa, VCLF
- **Reorganized coal companies**
- **Overseas Entities:** not as likely this go around

Market Reaction to Peabody's Asset Sale

November 20: Peabody announces sale of CO/NM assets to Bowie Resources for $358 mm cash

- ✓ Bowie to assume approx $105 mm of related liabilities
- ✓ Deal releases Peabody of +$300 mm of self-bonding reclamation liabilities
- ✓ Assets projected to generate $70 mm of pre-tax/capex cash flows in 2016

- ➢ BTU shares up 15.9% at open on 11/23, but rally faded and ended day up 3.7%
  - o Equity down 70%
  - o 6.00% senior unsecured notes due Nov 15, 2018 down 54% to $9
  - o $1.5 billion outstanding – will BTU use cash from sale to buy back?
- ➢ 10.00% second lien notes due March 2022 down 29% to $18

Bifurcated deal flow

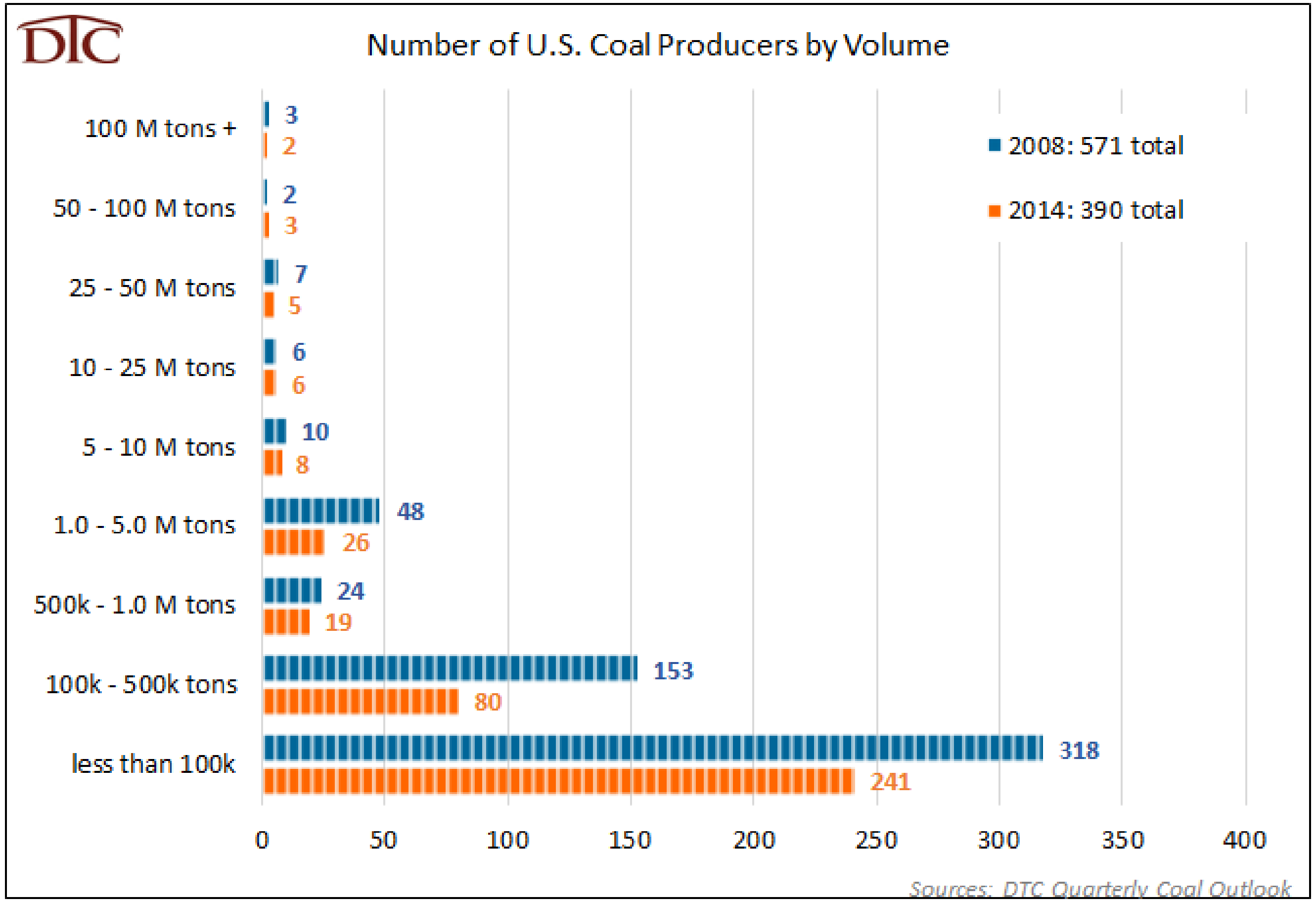
- Small transactions of non-core mines from distressed producers to local buyers for nominal amount
    - Producers shedding liabilities, buyers adding contiguous reserves
- Operating assets sold to strategic buyers for ‘fair value’ prices
    - Disconnect between seller expectations and buyer considerations still exists
- <u>Market needs shift to “constructive consolidation”</u>

Constructive Consolidation

- Acquisitions that result in supply cuts
  - Alliance's acquisition of Patriot's WKY assets (Jan 2015)
  - Murray's investment in Foresight Energy (Mar 2015)
  - Alpha asset auction
- Difficult to justify
  - Why acquire to close?
  - ARO impacts valuation
- Radical change needed to accelerate return to balance

The marginal producer matters

	2008	2014
Number of Producers	571	390
Average production	2.0 mm tons/yr	2.6 mm tons/yr
25 Largest Producers	982.0 mm tons (84%)	886.7 mm tons (88%)
Prod. with <1 mm tons/yr	59.7 mm tons	40.3 mm tons



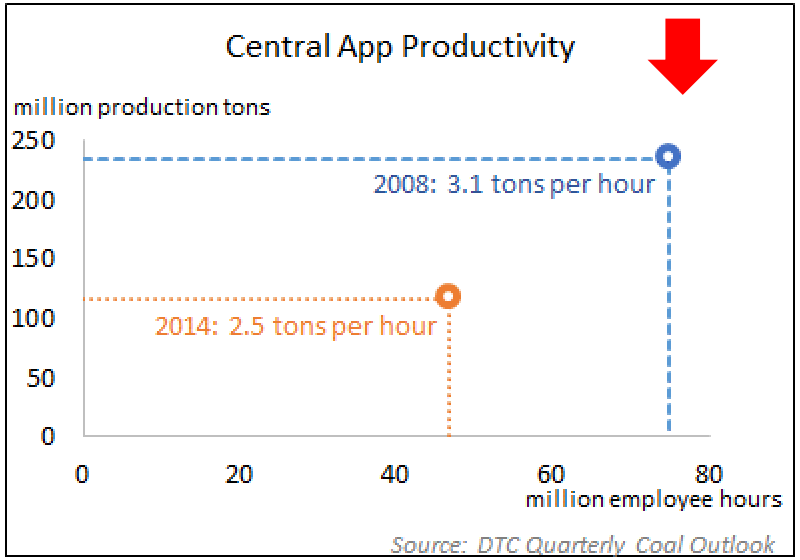
U.S. coal market in 2018

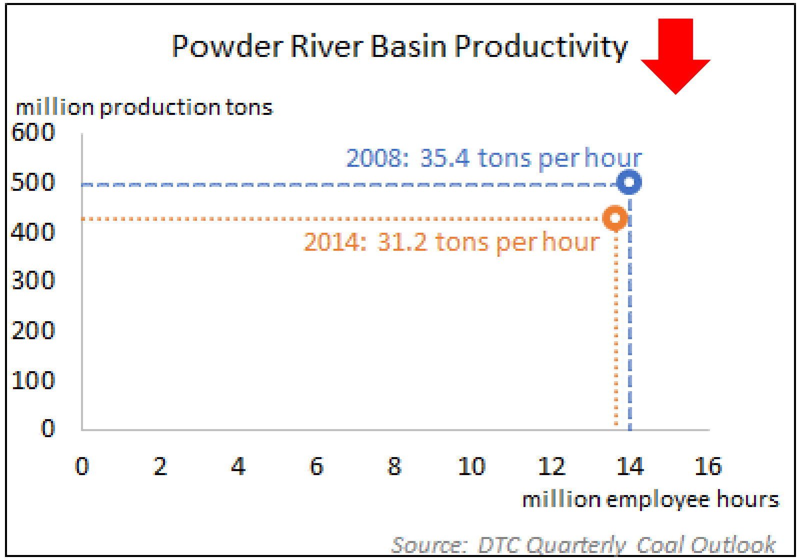
Supply cuts accelerate in ’16, then stabilize

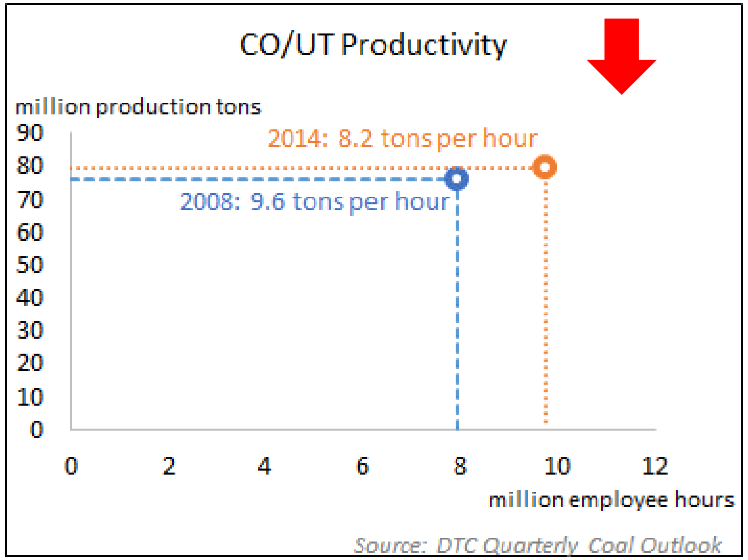
- Every basin impacted
- Lower cost base after restructurings results in ‘sticky’ supply, even in depressed market
- Utility stockpiles are another buffer to demand, delaying need for new purchases
- Constructive consolidation needed to accelerate closures

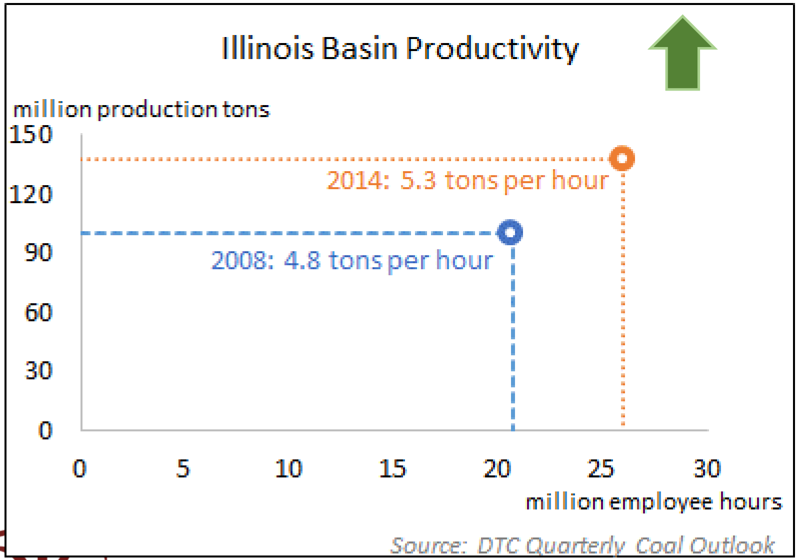
Supply	2015	2016	2017	2018
Capp	91	80	76	70
CO/UT	35	30	28	28
ILB	128	114	112	110
Napp	116	96	90	90
PRB	415	370	365	360
Other	116	103	103	99
Import	10	10	10	10
Total	911	803	784	767

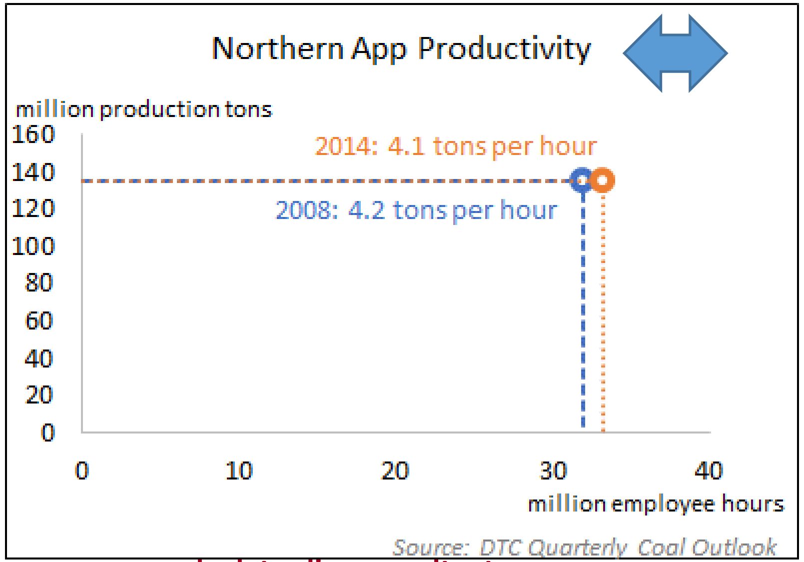
Productivity gains evasive

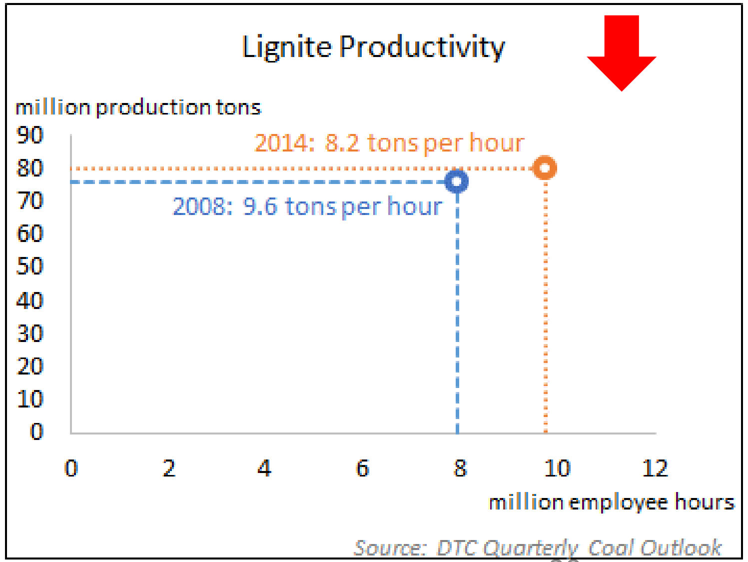












Demand declines will slow after 2016

- Utility demand braces for a 60 mm ton YoY decline in 2016
  - Will feel worse than 2015 due to high utility stockpiles
  - Upside/downside to forecast driven by weather and natgas
  - Long-term stabilization between 600 - 650 mm tons/yr
- Exports – more push than pull

Demand	2015	2016	2017	2018
Utility	750	690	700	700
U.S. met	20	19	20	20
Industrial	41	38	37	36
Res/Com	2	2	2	2
Met export	46	30	28	28
Thermal exp.	25	20	18	18
Total	884	799	805	804

Wrap up

Conclusion

- Steady stream of M&A between 2016 and 2018
  - Bifurcation between distressed sales and strategic acquisitions
  - Constructive consolidation a must!
- Restructurings continue, but assets slow to close
- Pain is not over, but demand declines not as severe as 2015
- Radical change needed for near term return to sustainable market

Thank You

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