Coal – US

Biden energy platform accelerates challenges for US thermal coal; expect secular decline under both platforms

Thermal coal producers — already reeling from a combination of challenges including market disruption following outbreaks of coronavirus and diminishing access to capital that limits resilience to further weakness — would see an accelerated decline in demand under the policies proposed by Democratic candidate Joseph Biden. Republican President Donald Trump and Biden are far apart on environmental issues, including on climate change and decarbonization proposals that will directly affect coal companies. Importantly, demand for thermal coal will remain in secular decline in the 2020s regardless of the winner of the presidential election given expectations for a small improvement in 2021 followed by continued contraction driven by a combination of factors including persistently low natural gas prices, increasing emphasis on renewable energy, and long-term regulatory uncertainty. State-level regulation is also an important factor influencing the demand for thermal coal. However, we expect the energy policy under a Biden Administration would accelerate the decline of thermal coal.

Exhibit 1
Coal consumption by U.S. electric power sector is declining rapidly

Our analysis of the credit effects of the potential implementation of the policies of both candidates in the upcoming US presidential election is summarized by a Republican platform that includes continued relaxation and rollbacks of various environmental regulations, and a Democratic platform that places “greening the economy” at the center of growth — and climate-related policy proposals, which would have substantial negative implications for the thermal coal industry. Companies with significant thermal coal production and negative rating outlooks include Alliance Resource Operating Partners (Ba3 negative), Arch Resources...
(B1 negative), CONSOL Energy (B2 negative), and Peabody Energy (B3 negative). The pace and magnitude of any policy changes, compared with what is in the parties’ platforms, depends on the results of the presidential contest as well as key races that will determine the eventual makeup of Congress. Some changes could be implemented without a Congressional mandate (such as regulations from the US Environmental Protection Agency).

Biden’s plans to achieve carbon-free electricity by 2035 would increase pressure on utilities and power generators to reduce emissions and an associated acceleration in the secular decline in demand for thermal coal in the US (see: "Next administration will confront five policy challenges with wide-ranging credit impact” 5 October 2020). The plan would establish a technology-neutral Energy Efficiency and Clean Electricity Standard, accompanied by clean energy tax credits meant to incentivize utilities and grid operators to improve energy efficiencies and generate electricity with renewables. Coal-fired power plants would be hit harder and more quickly than other fossil fuels (including natural gas). Unregulated power generators, in particular, would be directly exposed to the market effects of new environmental regulations, because they would be unable to recover increased compliance costs from rate payers, leading to a reduction of coal-fired units in the context of a broader set of positive developments. President Trump, meanwhile, has pursued a policy agenda considered favorable to the coal industry that has helped preserve some demand for thermal coal. While we expect that a second Trump administration would continue to promote a policy agenda that is generally favorable to the coal industry, efforts to this point have been insufficient to reverse the decline in demand that started in the late 2000s. Domestic demand for thermal coal in the United States has declined significantly over the past few years with more retirements of coal-fired power plants expected in the near-to-medium term and an export market that is insufficient to pick up the slack even in an improving price environment scenario.

Our global outlook for the coal industry is stable based on modest improvement in business conditions expected in 2021. However, the prospective improvement in business conditions is insufficient to alleviate pressure on US thermal coal producers, which face a variety of unique challenges compared with producers in other regions and remain highly vulnerable to further economic weakness. Most US coal companies, including all thermal coal producers, were downgraded or faced other negative rating actions in 2020. Demand for thermal and metallurgical coal was hit hard by diminished demand for electricity and steel, respectively, after the coronavirus spread globally. Most coal companies still have negative outlooks in response to cash burn, weakened liquidity, and significant uncertainties surrounding the prospect of a modest recovery in domestic and international coal prices in 2021. While we expect economic recovery in 2021 and some recovery in the coal burn as well, coal inventories are high. This will limit the extent to which economic recovery results in greater coal purchases as would be the case in a normal inventory environment. Thermal coal producers are also vulnerable to short-term market weakness, as well as longer-term debt capacity issues, such as in a scenario in which the coal industry’s decline gathers pace and therefore companies’ reclamation-related spending must also accelerate.

Some US coal producers we rate are less immediately vulnerable from a credit standpoint. Foresight Energy (B3 positive), which recently emerged from bankruptcy, has attractive cash costs across its thermal coal portfolio and, importantly, very low absolute debt. Contura Energy (Caa1 stable) has a low rating today, which incorporates significant near-term risks, and focuses more heavily on metallurgical coal. Warrior Met Coal (B2 positive) is best-positioned with an exclusive focus on metallurgical coal.

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