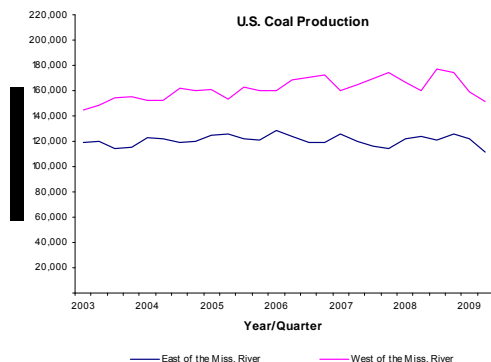


Summary

The country's continued recession led to a second consecutive quarter of pronounced contraction in the coal industry. The combination of lower consumer demand for electricity and steel both at home and abroad resulted in almost double-digit decreases in production, consumption, imports and exports relative to their previous quarter levels. The decrease in consumption was greater than the decrease in production, however, which resulted in stocks rising to even higher levels. In fact, after reaching their highest levels in 20 years during the first quarter of the year, stocks rose to their highest level ever during the second quarter, barely surpassing the previous record set in 1980. Despite the softening coal market, a lag effect from existing supply contracts ensured that delivered coal prices fell by a much smaller amount.

Production

After several quarters of particularly high levels of production brought about predominantly by the increased demand for metallurgical coal in China and India and supply disruptions in Australia, U.S. coal producers have clearly begun to feel the impact of the global economic downturn. Despite the presence of existing supply contracts – which serve to delay and spread out the economic impact – U.S. coal production decreased for the second consecutive quarter. Specifically, production fell by 6.7 percent to 262.6 million short tons (mst) from 281.4 mst in the first quarter of the year and by a total of over 12 percent from 299.6 mst in the fourth quarter of 2008. While some of this decrease can be attributed to seasonality, production was also 7.6 percent lower than during the comparable quarter of 2008. In fact, production during the second quarter fell to its lowest level in 9 years.



No longer buoyed by high global demand and faced with decreasing prices and demand, U.S. coal producers have continued to either reduce shifts at mines or to

temporarily close mines until prices and demand recover. This effect was particularly pronounced in the Appalachian Region where production, until recently, had been supported by strong foreign demand for metallurgical coal. In addition, rising production costs resulting from a shortage of skilled labor, new underground safety requirements, and the difficulty of obtaining permits for new surface mines also contributed to suppressing production in the region.

Between the first and second quarter of 2009, production in the Appalachian Region fell by more than 11 percent to 84.0 mst. This new level represents a decrease of more than 14 percent from two quarters prior and a decrease of more than 15 percent from the comparable quarter of last year. Unless the global economy experiences a dramatic turnaround, the region may not be able to quickly recover from its present contraction.

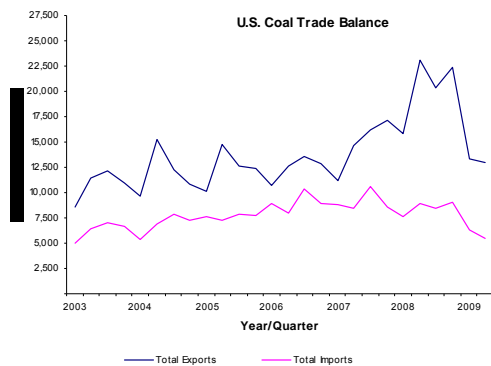
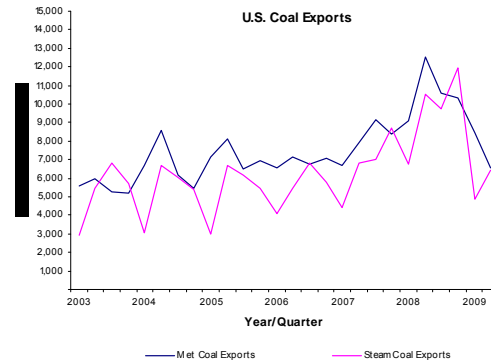
Production in the western U.S. – which includes the Powder River Basin (PRB) – also decreased between the first and second quarters of the year but not as much as in the Appalachian Region. Specifically, production fell by almost 6 percent to 141.0 mst in the second quarter from 149.6 mst in the first quarter. Production decreased by a similar amount relative to the same quarter of last year. In Wyoming, which accounts for approximately 39 percent of total U.S. production, coal production fell to its lowest level since the end of 2005.

While production fell in the Western U.S. and in the Appalachian Region, it actually increased in the Interior Region, albeit by only 1 percent from 36.9 mst to 37.3 mst, its second highest level since 1999. In fact, of the 10 largest coal-producing states in the country (which together account for almost 90 percent of the country's production), production increased only in Pennsylvania, Illinois and Texas by a total of about 1.5 mst.

Exports and Imports

After maintaining exceptionally high levels during most of 2008, coal exports fell for the second consecutive quarter. During the second quarter of 2009, U.S. producers exported 13.0 mst of coal, 2.9 percent less than they exported during the preceding quarter but 42 percent less than they exported during the final quarter of 2008. While the new second-quarter level represents a significant drop from 2008, it is much more representative of historical exports during that time of year. Before supply shocks at major international coal exporters such as Australia and exceptionally high demand in countries such as China and India combined to boost exports during the second, third and fourth quarters of 2008 (when they totaled 23.1 mst, 20.3 mst and 22.3 mst, respectively), quarterly exports had not surpassed 20 mst in almost 10 years. Moreover, between 1999 and 2007, second-quarter coal exports averaged 13.6 mst.

Since the economic downturn has been felt world-wide, exports have fallen across the board to almost all of the country's trade partners over the previous two quarters. Exports to Canada, historically one of the largest consumers of U.S. coal, increased slightly between the first and second quarters of 2009 from 1.2 mst to 3.4 mst but remained well below the 2008 second quarter levels when exports to Canada totaled 7.2 mst. Similarly, U.S. coal producers exported 24 percent less coal to Europe between the first and second quarter of 2009. European exports dropped 42 percent from 2008 second quarter levels.



The economic recession has affected the demand for U.S. steam and metallurgical coal in slightly different ways. Since steam coal exports reached their all-time high during the fourth quarter of 2008 the fact that they were almost cut in half only two quarters later, falling from 12.0 mst to 6.4 mst is significant. However, the second-quarter total is consistent with historical exports. For example, during the 9 years prior to 2008, steam coal exports during the second quarter never fell below 4.9 mst, never exceeded 6.8 mst and averaged 6.2 mst.

In contrast, metallurgical coal exports hit a recent peak during the second quarter of 2008 at 12.6 mst (the all-time high occurred in mid-1996 at 14.0 mst) and have been decreasing ever since. While metallurgical coal exports fell by 23 percent between the first and second quarters of the year, they have fallen by 48 percent since the second quarter of 2008. More importantly, however, metallurgical coal exports fell below their pre-surge levels, reaching their lowest second quarter level since 2003.

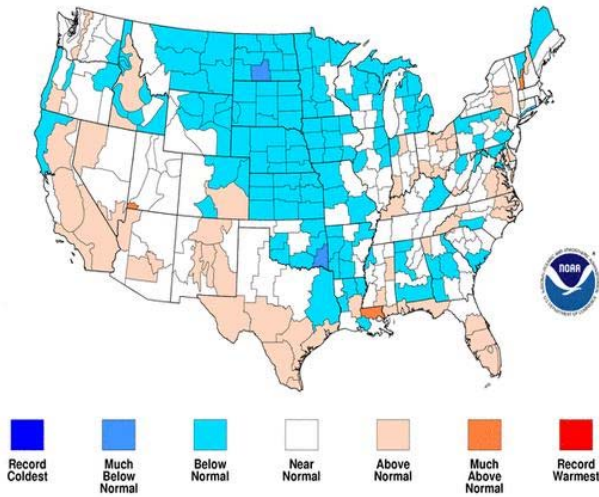
The decreased demand for U.S. coal abroad may also signal an end to the industry's attempt to export western coal. Historically, almost all U.S. coal exports have been shipped out of ports along the Gulf Coast and eastern seaboard (especially Mobile, New Orleans, Norfolk, and Baltimore) due to the lack of suitable facilities along the west coast and the increased costs associated with transporting coal from the mines to the ports. During 2008 and the start of 2009, however, railroads and coal producers began exploring possibilities of increasing the amount of coal exported from the west coast. While some test shipments were sent from ports in and around Los Angeles and other ports in the Western U.S., indications pointed to Vancouver being the most promising port for exporting western coal. EIA data does not differentiate between U.S. coal shipped abroad from Vancouver from U.S. coal shipped to Canada for consumption in the country since all such shipments appear as exports to Canada.

Between the first and second quarters of 2009, U.S. coal imports fell by 14 percent to 5.4 mst, their lowest level since the first quarter of 2004 and their lowest second-quarter level since 2002. As in previous quarters and years, the majority of imported coal originated in Colombia (82 percent). Most of the imported coal was received in Mobile, AL (27 percent) but Tampa, FL and Boston, MA also received significant amounts (16 percent and 13 percent, respectively).

Consumption

Total U.S. coal consumption fell by over 9 percent between the first and second quarters of 2009 to 231.7 mst, its lowest quarterly level in 14 years. Since the electric power sector accounts for more than 90 percent of the country's coal consumption, the decrease was most likely a result of consumer cut-backs in electricity usage across all end-use sectors.

Average U.S. Temperatures, April - June 2009



The lower demand was aided by the fact that the second quarter of 2009 witnessed fairly normal weather. Based on records going back to 1895, as maintained by the National Oceanic and Atmospheric Administration’s National Climate Data Center, the average national temperature between April and June was approximately at historical average, compared to warmer-than-normal temperature a year ago.

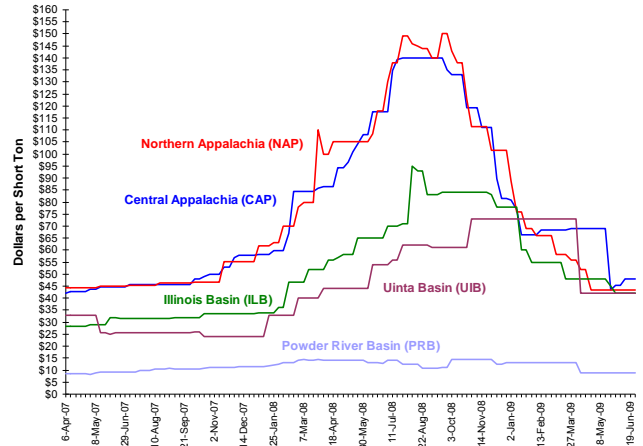
Domestic Prices

As a result of long-term contracts signed by coal consumers when prices were higher, domestic coal prices did not fall with demand. Specifically, while demand for coal fell significantly between the first and second quarters of 2009, the average price of coal delivered to the electric power sector (determined by averaging the three monthly rates) only fell from \$2.25 per million Btu to \$2.22 per million Btu. This new price is, however, almost 10 percent higher than it was during the second quarter of 2008 when it was \$2.02 per million Btu. For more information on delivered price data see Table 4.10.A in the Electric Power Monthly at www.eia.doe.gov/cneaf/electricity/epm/epm_sum.html.

The price of coal sold on the short-term market often tells a very different story since the vast majority of coal

is sold under long-term contracts. As shown by the following graph, the spot prices for Central Appalachian, Uinta Basin and PRB coal each fell by more than 30 percent between the end of the first and second quarters of 2009 (decreasing by \$20.95, \$31.00 and \$4.25, respectively) while the spot price of Illinois Basin coal fell by \$6.00 or 12.5 percent. The lower spot prices most likely will put downward pressure on future contract prices as contracts are adjusted or renegotiated.

Historical Average Weekly Coal Commodity Spot Prices (2007 Q2 – 2009 Q2)



Source: With permission, Platts Coal Outlook, "Weekly Price Survey." For more information see www.eia.doe.gov/cneaf/coal/page/coalnews/coalmar.html.

Stocks

Reduced coal consumption brought about by lower electricity demand combined with previously contracted supply agreements continued to drive up consumer stock levels around the country. After reaching their highest level in more than 22 years during the first quarter of 2009, ending stocks increased by an additional 11 percent between the first and second quarters. The new consumer stock level of 205.6 mst is now the highest level in the country’s history, exceeding the previous record set at the end of 1980. In fact, during the 9 month period starting with the end of the third quarter in 2008, consumer stocks have risen by 34 percent.