New capital opportunities for tomorrow's coal sector

By Aubrey Chauke

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Despite huge advances in clean coal technologies, abundance of coal in the SADC region and Southern Africa's vast energy needs, and the reality that coal will remain an important element of South Africa's energy mix well beyond 2040, most of South Africa's major banks, in line with those in the developed West, are reassessing their willingness to fund future coal projects.

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It is estimated that there are approximately 130 fully operational coal mines in South Africa. In short, there are more coal mines in the country than any other kind of mine. South Africa is also currently producing about 240-million tons of coal a year, the same as a decade ago.

The difference in 2020, compared with 2010, however, is that, today, 20% of the volumes produced are supplied by 53 mines operated by juniors, many of them emerging miners. It's a credit to both inclusion and transformation that today 53 fully operational coal mines exist outside the mining majors in South Africa. It is also noteworthy that given the dearth of traditional funding, most of the investment for these mines has come from elsewhere.

Sources of capital

Since establishing the most basic coal operation required capital of anywhere between R50m-R100m, it is important that the industry understood where future capital for coal mining projects would come from. While South Africa’s leading banks and development institutions needed to evolve clear guidelines on the funding of clean coal on a sustainable basis, if the coal sector is to continue to transform by adopting new technologies, retrofitting old infrastructure and providing economic opportunity to more South Africans the sector should understand that the funding game had changed.

There is a definite appetite among international investors from within the industry, especially among end-users in Europe, the Middle East and Asia. Coal end-users and global commodity traders seeking to secure their own supply lines, for example, are increasingly likely to provide capital. Private equity funds seeking higher returns in a globally flat interest rate environments are also becoming more adroit at understanding investment in coal projects. It is also noteworthy that regional and development banks in Africa, the Middle East and Asia – especially among the larger coal off-take markets – remained willing to fund well-structured projects. Many of these banks are ahead of the curve in developing clear sustainability guidelines for the funding of coal projects and are reaping the rewards.

Listing is no longer an option for most stand-alone coal projects. The days of single asset-listed companies are over. Today, market values are almost always significantly below asset values. The upshot is that there was a lot more international money in the South African coal sector today than a decade ago.

Coal juniors and emerging miners should understand the much broader – and better informed - global funding ecosystem currently evolving. Financing coal projects generally in Africa, particularly in the SADC region, meant that investors needed to be guided and educated on risk – political, environmental and infrastructural. Once risks are clearly identified – and matched with clear mitigation strategies - projects become attractive to alternative funders. In short, the business cases remains critical. The ideal candidate for investment should have, at minimum; a mining right, proven reserves, an experienced team and a clear market. A secure logistics path is critical too. In Africa, logistics accounted for up to a third of the price. Being able to show clear off-take contracts with end-users both locally and internationally is also essential.

Diversified receivers

While it is great to have an Eskom supply contract in the bag as the power utility remained a solid payer, there is, today, a more diversified set of receivers domestically than a decade ago. In addition to the growing number of privately owned power stations in the domestic market, the wood pulp sector, including majors like Sappi and Mondi, is a large receiver of coal. The cement and poultry industries are also set to remain long-term offtakers.

Similarly, state and private hospitals and prisons also take up a lot of coal. There is also a big opportunity in South Africa, for example, to match coal reserves to local processing plants or nearby power stations. Going forward, a lot of power stations would be retrofitted with cleaner coal technology as they remained essential components of broader energy generation and supply infrastructures.

The broader SADC region was also important when looking to leverage assets to their full commercial potential. Having an asset with a power production facility near to a border or close to an existing grid, for example, added considerable weight to funder propositions. Lurco, for example, was currently transitioning from a commodities business to a commodities and energy company, leveraging its power generation assets in Botswana and South Africa for broader regional energy supply.

In conclusion, the coal industry should focus funding efforts on the capital sitting amongst contractors, corporate suppliers, end-users, global traders and within global private equity markets. The industry, especially junior miners, should deepen relevance to this capital and as well as the much broader off-taker ecosystem that existed today by leveraging their businesses via as many asset combinations, technologies, partnerships and collaborations as possible - locally, regionally and globally.

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