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HNRG - Q1 2016 Hallador Energy Co Earnings Call

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CORPORATE PARTICIPANTS

Rebecca Palumbo *Hallador Energy Company - Director of IR*

Larry Martin *Sunrise Coal LLC - CFO*

Brent Bilsland *Hallador Energy Company - CEO, President*

CONFERENCE CALL PARTICIPANTS

Mark Levin *BB&T - Analyst*

Lucas Pipes *FBR - Analyst*

PRESENTATION

Operator

Good afternoon and welcome to the Hallador Energy first quarter 2016 earnings conference call. All participants will be in a listen-only mode. (Operator Instructions). Please also note today's event is being recorded.

At this time, I would like to turn the conference call over to Becky Palumbo, Director of Investor Relations. Ma'am, please go ahead.

Rebecca Palumbo - *Hallador Energy Company - Director of IR*

Thank you and good afternoon, everyone. Thanks for joining us today to discuss our first quarter 2016 earnings. With me on the call today are Brent Bilsland, our CEO and President, and Larry Martin, our CFO. Following these remarks today we will open the call for Q&A. This conference call is being webcast live on our website and a replay will be available for your convenience followed by a transcript later this week. If you have a question after the call, please reach out to me afterwards.

Our remarks will include forward-looking statements that are subject to certain risks and uncertainties that could cause actual results to differ materially. For example, our estimates of mining costs, future coal sales and regulations relating to the Clean Air Act and other environmental initiatives. We do not undertake to update our forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by law.

With that, I will turn it over to Larry.

Larry Martin - *Sunrise Coal LLC - CFO*

Good afternoon, everyone. I'm going to review our quarterly operating results. For the quarter we had net income of \$6.2 million or \$0.21 a share. We define our free cash flow as pretax income plus DD&A plus stock compensation less capital expenditures. Free cash flow was \$11.6 million or \$0.40 a share. Our adjusted EBITDA, which is EBITDA plus related stock compensation, was \$23.5 million or \$0.80 a share. Our debt increased by \$6.6 million or \$0.22 a share and this was related to a \$15 million borrowing for the Freelandville assets that Brent will explain later and then an \$8.4 million debt payment. We paid dividends of \$1.2 million or \$0.04 a share in the quarter.

At the end of the quarter we had bank debt of \$256 million. Our net debt after -- [with] cash was \$242 million. Our debt target for the end of the year is \$230 million to \$235 million that we think will be at the end of 2016. Our debt to adjusted EBITDA at the end the quarter, the trailing 12 months, was 2.89 times.

I want to turn the call over now to Brent to talk about our comments and insight going forward.



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Brent Bilsland - Hallador Energy Company - CEO, President

Hello, everybody, and thank you for joining the call. Our big news for the quarter was on March 22 we completed the purchase of reserves and coal sales agreement from Triad Mining for \$18 million. These reserves totaled \$14.2 million of fee and lease coal and will be mined from our underground mine at the Oaktown 1 portal. This purchase also allows Sunrise to access another 1.6 million tons of our reserves that we already control but were previously inaccessible. So net effect, Oaktown 1 reserve will increase by 15.8 million post the transaction. The purchase coal sales agreements totaled 1.4 million and will be delivered during the calendar year of 2017. This brings our coal sales position to 4.6 million tons for 2017.

For full year 2016, we are forecasting sales of 6 to 6.5 million tons. We shipped 1.6 million tons in the first quarter, so therefore we currently have another 4.4 million tons under contract for the balance of 2016. In some cases, our customers have the ability to increase contract tonnage and/or are required to purchase their additional needs from our company. In addition to our contract position, we continue to see RFPs from a few customers so we think there's a good chance we may sell some coal remaining this year. We expect our average price for the balance of 2016 to be in the \$43 a ton range.

Production costs -- Oaktown's cash costs for the first quarter was \$27.87. For the remainder of 2016 we continue to forecast our costs at Oaktown to be in the \$28 to \$30 per ton range. Going forward we expect our SG&A to be \$12 million annually and costs associated with Prosperity and Carlisle to be in the \$9 million range annually.

On the debt side, on March 18 we executed an amendment to our credit facility with PNC as our administrative agent to our credit agreement. The primary purpose of the amendment was to increase liquidity and maintain our compliance through the maturity of our agreement in August of 2019. Some of the changes -- our revolver was reduced from \$250 million to \$200 million. The term of the loan remains the same. Our debt as of the end of the quarter was \$256 million, consisting of \$131 million of term debt and \$125 million on our revolver. As Larry said, our debt did increase during the quarter by \$6.6 million, mostly due to our \$18 million purchase of assets from Triad. Our total liquidity at the end of the quarter, which would be our credit facility plus cash, was \$81 million. We continued to generate cash in the first quarter. As Larry stated, free cash flow was \$11.6 million. In the first quarter we also paid, yet again, a \$1.2 million dividend or \$0.04 a share.

Tonight is Hallador's shareholder annual meeting. It's at 4PM at Stables Steakhouse here in Terre Haute, Indiana. The PowerPoint presentation from that event will be posted to our Hallador website following the call.

So with that, I'm going to open it up to questions.

QUESTIONS AND ANSWERS**Operator**

(Operator Instructions). Mark Levin, BB&T.

Mark Levin - BB&T - Analyst

Hi, Brent. A quick question on customer inventory levels, your key customer inventory levels. Any approximation as to where they are now, how far above normal they might be?



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Brent Bilisland - Hallador Energy Company - CEO, President

Well, I think the majority of coal customers have high inventory levels. That being said, we did make an additional sale in the quarter so there's still customers out there that are buying; everybody's in a different position. Also, as part of the transaction, we have modified agreements to help customers get their inventory levels in a better position.

So it's really hard to say. I would say in general, inventory levels are high but people are working on pushing coal out to next year and beyond and trying to get themselves in a more comfortable spot.

Mark Levin - BB&T - Analyst

Brent, when you kind of look at your key customers, what natural gas price do you need, where you feel like demand's really going to start to pick up? Is it a \$3 number, is it a \$2.50 number? I realize the transportation component is important and every coal producer probably has a different number but are you closer to \$2.50 or more at \$3 and above, in your estimation?

Brent Bilisland - Hallador Energy Company - CEO, President

I think at \$3 Indiana coal is in pretty good shape. Not killing it, but in decent shape. I think at \$2.50 gas starts to steal market share. So it depends on what the transportation rate is. That's a big part of it.

And if you had to think about -- like again, congratulations on the Triad deal but when you think about like shipments next year, I know you're not in a position to give guidance but just assuming the world is in a little bit better place, where can that -- let's just call it 6.3 million ton midpoint. What could that look like in the outer years, in 2017 and 2018? And let's say gas is \$3. What's a reasonable number to think about?

I would say in general, we think that -- the slideshow tonight, we're going to talk about that here at our annual meeting. But I think in general, 2015 was the perfect storm. I mean, we have got -- the dollar appreciated 20% to most currencies. That hurt exports. You had record gas production and then this year we had the warmest winter on record in 130 years of record-keeping. So gas has no place to go, so it has to price down to a point to where it can displace coal, and we saw gas prices get down in the \$1.60 range.

If you think about that, even though \$1.60 is the low point this year -- \$1.64, wherever it was -- coal is still going to maintain about a 30% market share. We think that -- and we don't think there's any gas producers anywhere in the country that make money below \$2.50. I think the majority of producers -- and again, this is in our slide presentation that will be on our website, but we think that even the lowest-cost producers need to have \$2.75 or more to have any return on capital long-term. So certainly there's gas companies that have lower finding costs but they're in areas where there is not enough pipeline supply to get the gas out.

So all this is really a long way of saying that we have a glut of BTUs, due to various events, and it's going to take -- a lot of 16 tons are going to get pushed to 2017. We think coal burn will be higher in 2017 but basically it's going to be a year of utilities working through stockpiles. How quickly that will happen will depend on what's the weather this summer and what's the weather this coming winter going to look like, which will determine the speed at which inventory levels get back in balance. We kind of think late 2017 we could see some aggressive buying. Time will tell. We think 2018 looks pretty good. So I think again, that's a long way of saying that 2017 is probably the harder year and 2018 looks more favorable.

Mark Levin - BB&T - Analyst

Interesting. Last question from me. Market prices today, are they sort of low 30s, mid-30s, upper 30s when you think about where you can contract?

Brent Bilisland - Hallador Energy Company - CEO, President

Mark, you ask this question every call and I don't think I've ever answered it.



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Mark Levin - *BB&T - Analyst*

Are you sure? I don't think I've asked -- I think this is the first time I've asked this. It might have been someone else.

Brent Bilisland - *Hallador Energy Company - CEO, President*

Uh-huh.

Mark Levin - *BB&T - Analyst*

All right, guys. I appreciate it.

Brent Bilisland - *Hallador Energy Company - CEO, President*

I think it's tattooed on your right arm or something.

Mark Levin - *BB&T - Analyst*

Yes, it might be.

Brent Bilisland - *Hallador Energy Company - CEO, President*

We don't give guidance on (multiple speakers).

Mark Levin - *BB&T - Analyst*

You don't want to go there. I got you. No, I completely understand.

Well then that allows me to sneak in one more question to Larry. Interest expense obviously for the quarter looks different than what it did in previous quarters. Should we just assume that this is the new ongoing -- the quarterly interest expense now is sort of the way to think about it going forward?

Larry Martin - *Sunrise Coal LLC - CFO*

Yes. With our debt reduction, of course it's going to go down a little bit every quarter but yes.

Mark Levin - *BB&T - Analyst*

Perfect. Thanks, guys. Appreciate it.

Operator

(Operator Instructions). Lucas Pipes, FBR.



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Lucas Pipes - FBR - Analyst

Hey, good afternoon, everybody. I think it's typically my favorite question to ask on the pricing side but I'm glad Mark gave it a shot. So I'll ask about --

Brent Bilisland - Hallador Energy Company - CEO, President

I apologize to Mark for falsely accusing him.

Lucas Pipes - FBR - Analyst

So on the contract side, if I look at 2017, you have roughly 2 million tons or so between the minimum and the maximum and I would say that's a pretty wide range and of course kind of it implies that where stockpiles are, to really be comfortable, you probably would have to increase that minimum sold number. Could you maybe put some numbers around it? What number would you be comfortable with exiting the year? And then also, in light of your covenants, what do you think kind of is the minimum amount of coal you need to sell in order to be in compliance throughout 2017?

Brent Bilisland - Hallador Energy Company - CEO, President

Well, I think -- the first part of your question, I think that if you look at our contracts, we're going to end up more towards the minimum side, just because I think the majority of customers are long coal. To the other part of the question, we would like -- if you look at this year, we are at -- what is it, roughly 6.1 million in sales right now? I think we had a decent quarter. So if we could get to that range in 2017 I think we would be fairly happy. We always hope to do better but it's certainly a goal of ours and quite frankly we think it's one that's very achievable.

Lucas Pipes - FBR - Analyst

Got it. So can you help us a little bit how to think about that minimum sold figure? What would take you to the minimum versus what allows you to maybe add on some additional tons to maybe get to that 6.1 million figure that I think you mentioned?

Brent Bilisland - Hallador Energy Company - CEO, President

Well, I think that under existing contracts we're going to be closer to the minimum and I think we're going to have to add new sales to get to a 6 million ton pace.

Lucas Pipes - FBR - Analyst

Got it. Okay. I'm not going to ask about the pricing for the new -- but maybe to switch to the cost side, you've done a good job at Oaktown. Just kind of what -- could you maybe give us a little bit of an update on whether you see additional cost-cutting opportunities, and if so, where? Then I think there was also an idle mine expense running through the first quarter. Where do you expect that to go over the course of 2016 and then maybe also longer term, assuming the status quo holds?

Brent Bilisland - Hallador Energy Company - CEO, President

So Oaktown cash costs for the quarter was \$27.87, which was below our range for what we predicted in our 10-K. We ran at a 1.6 million ton pace per quarter. I think that we sold at a 1.6 million ton pace; we produced at a 1.5 million ton pace. We've got 4.4 million to ship for the balance of the year. We continue to forecast our costs to be \$28.30. If we run a little faster it's going to be closer to \$28. If we run a little slower, it's going to be closer to \$30.

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Lucas Pipes - *FBR - Analyst*

Got it.

Brent Bilisland - *Hallador Energy Company - CEO, President*

As far as costs with Prosperity and Carlisle, that is something that we're working on. I do think that there's a chance of seeing cost reduction there later this year.

Lucas Pipes - *FBR - Analyst*

So we should just stay tuned, or any sense in terms of where it can go or what we should be modeling in?

Larry Martin - *Sunrise Coal LLC - CFO*

Right now we're estimating 9 million annually for those two.

Lucas Pipes - *FBR - Analyst*

Okay. And then assume the same for 2017 at the status quo? Or should we maybe take that a notch down?

Brent Bilisland - *Hallador Energy Company - CEO, President*

I don't think we're ready to give guidance out there yet. I think we'll just stick with -- again, I think we're working on some things to -- we think we've got a shot to reduce that cost. We're really not ready to say any more than that at this time.

Lucas Pipes - *FBR - Analyst*

That's fair enough. I appreciate all the color. I hope you have a great time tonight and I wish I could be there but I'm there in spirit. Good luck for this year as well.

Brent Bilisland - *Hallador Energy Company - CEO, President*

All right, thank you, Lucas.

Larry Martin - *Sunrise Coal LLC - CFO*

Thanks, Lucas.

Operator

(Operator Instructions). Ladies and gentlemen, at this time I'm showing no additional questions. I'd like to turn the conference call back over to management for any closing remarks.



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Brent Bilisland - Hallador Energy Company - CEO, President

Well, I thank everyone for taking the time to listen to our call. I would encourage you all to go to the Hallador website and take a look at our slide presentation. It talks a lot about the state of the industry, a little less about Sunrise and more about the state of the industry and what our viewpoints are there. I think that's it. So thank you very much for taking the time to listen to us today.

Operator

Ladies and gentlemen, that does conclude today's conference call. We do thank you for attending. You may now disconnect your telephone lines.

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