Hallador Energy Company

Second Quarter 2017 Earnings Conference Call and Webcast

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CORPORATE PARTICIPANTS

Brent Bilsland - *President and Chief Executive Officer*

Larry Martin - *Chief Financial Officer*

Becky Palumbo - *Director, Investor Relations*

PRESENTATION

Operator
Good day and welcome to the Hallador's Energy's Second Quarter 2017 Earnings Conference Call and Webcast. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone, to withdraw your question, please press "*" and then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Ms. Becky Palumbo, Director of Investor Relations. Please go ahead.

Becky Palumbo
Thank you, Brian. Good afternoon, everyone. Thank you for joining us in today's discussion of our second quarter 2017 results. This event is being webcast and you will be able to access a replay of this call on our website along with the transcript, later this week. Yesterday, we filed our second quarter Form 10-Q with the SEC, and it can be viewed or downloaded from our website.

Participating on today's call, are Brent Bilsland, our President and CEO and Larry Martin, our CFO. Larry will open with a brief financial overview of the quarter, followed by Brent with remarks on operations. After management completes their opening remarks, we will open the line for Q&A.

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.

Now, with that, I'll turn the call over to Larry.

Larry Martin
Thank you, Becky. Good afternoon, everyone. Let me go over the review of our operating results for the quarter. For the quarter, we had net income of $400,000 or $0.01 a share, $7.8 million, $0.25 a share for the six months ended June 30th. Our free cash flow for the quarter was $7.2 million and for the year, $27.1 million.

Our adjusted EBITDA was $20.4 million for the quarter and $44.3 million for the year. We reduced debt by $6.6 million for the quarter and $13.1 million for the year and we have paid dividends of $0.04 of share for the quarter $0.08 of share for the six months ended.

We define free cash flow as net income, plus deferred income taxes, depletion…depreciation and amortization, our reclamation accretion, our stock compensation less our maintenance CAPEX. We define adjusted EBITDA as EBITDA plus stock compensation plus reclamation accretion.

Our bank debt at the end of June totaled $225.5 million. Our net debt which included cash, CDs and marketable securities was $210 million. We still…we target our debt to be $210 million to

$215 million at the end of the year. And our debt to EBITDA ratio for Sunrise only for our bank covenant was 2.76 times at for the trailing 12 months.

I will now turn over the call to our CEO, Brent Bilsland. So he can make his statements about our results.

Brent Bilsland
Thank you, Larry. I am happy to report that Hallador has generated respectable six month and three month results. Dramatic reductions in cash cost per ton allowed Hallador to generate $44.3 million in adjusted EBITDA for six months and $20.4 million for the second quarter.

We look at free cash flow of $27.1 million for the first six months of the year and $52 million of free cash flow for our trailing 12 months. If you couple that with our market cap this morning of $188 million, we are trading at over a 27% free cash flow yield.

Our positive cash generation has allowed us to continue to pay down debt, maintain our dividend and invest in our business. I think Hallador has a tremendous value, especially when considering that our operations are currently operating at only 60% of capacity. Once again, we attribute Hallador's success to the men and women who choose to work here and their dedication to maintaining our low-cost culture.

Again, we experienced impressive cash cost on both the six-month and three-month basis. Oaktown's cash cost for the six months were $24.73, for three months they were $26.30. I would like to highlight that that is towards the lower end of our previous guidance of $26 to $28 a ton.

Companywide cash cost, so that's Oaktown cost plus Carlisle cost and Prosperity, our companywide cash costs were $27 a ton for the first six months and $28.47 for the three-month period. These costs are $3.77 lower and $2.54 lower than year-ago comparables.

Later this year, we anticipate the arrival of additional haulage equipment and the implementation of a new elevator at Oaktown 1, both investments will contribute to maintaining our low-cost culture.

We continue to maintain our companywide cash cost guidance of $26 to $28 a ton for the balance of the year. Our CAPEX budget for the balance of the year is $21 million of which $11 million is for maintenance CAPEX.

For the balance of the year, we expect our SG&A to be $5 million and costs associated with Prosperity and Carlisle to be $3.5 million.

Again, in the first quarter, we sealed off a large portion of the Carlisle Mine that had lots of problems behind it…behind the seal, and this should significantly reduce our cost of holding Carlisle idle.

Looking at our balance sheet; we continue to pay down debt by $6.6 million for the three months. And I think Larry said, $13.1 million for the year, deleveraging our balance sheet to 2.76 times debt to EBITDA and our liquidity remained a healthy $79 million at the end of June.

Looking at the market; we continue to see stronger market demand in 2017 than we did in ‘16. Natural gas inventory levels are much lower than a year ago. Utility coal inventory levels have also been significantly reduced.

The export market is much stronger than in years past. We currently have 6.2 million tons sold for 2017, and we maintain our projections that we will sell 6.3 million to 6.6 million tons for the full year.

We consciously increased our inventory levels in the first quarter, as inventory has remained elevator…and inventory has remained elevated in the second quarter due to transportation hiccups. However, rail service has been much more precise in the last five weeks and we are confident, inventory levels will normalize by yearend.

Looking at 2018; our customers continue to maintain a short term buying strategy. As we quickly approach the fall buying season, we feel confident that our customers have large open positions and we will be able to sell our tonnage, as we are the low-cost producer.

There are competitors with higher cost production whose legacy contracts expire at the end of this year and we are in the process of implementing test burns with a couple of new customers.

So with that, I am going to open up the call to questions.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question, you may press “*” then “1” on your touchtone phone. If you are using a speakerphone, please pick-up your handset before pressing the keys. If at anytime your question has been addressed and you would like to withdraw your question, please press “*” then “2.”

First question comes from Lucas Pipes with FBR & Company. Please go ahead.

Lucas Pipes
Yes. Good afternoon, everybody.

Brent Bilsland
Hi, Lucas.

Lucas Pipes
Good job on the cost side, you mentioned in your prepared remarks coming in at the low end of your guidance. I just wanted to maybe get a little bit more color on how sustainable you think it is, especially with an eye towards 2018 and beyond. Thank you.

Brent Bilsland
I think our costs are very sustainable, you know, if you look at, when we purchased the mine back in late 2014, at that time Oaktown had a cash cost of somewhere in the $33 range. So we’ve been able to, over time consistently reduce the cost of that mine and I attribute much of that to the management of our people, but also to the reinvestment into the mine that we’ve made every single quarter. Up to note with us, volume makes a big deal and we see you know, the first quarter as we ran harder and we produced more tons, we see our cash cost fall. So it’s

essential for us to stay above that 6 million mark on a sales side. If we can get to 7 million, our cost looks even better.

Lucas Pipes
Great, that's super. In terms of the idle mine costs, I thought you had made a reference to that in your prepared remarks. I just wanted to circle-up on where you think that's going to shake out, and then again, kind of, as we go to our models for 2018 and beyond, what's a good level to pencil in there?

Larry Martin
Well, assuming they're still idle, Lucas, I think the 3.5 we estimate for the rest of the year, we might shave a little off of that in '18. I am going to say somewhere between $6 million and $7 million for vital costs of both of those mines next year.

Lucas Pipes
Okay. And that would be the total for all operations…all idled operations?

Larry Martin
Correct.

Lucas Pipes
Okay, and then maybe switching over to the revenue side. I think, I asked this question to every producer. But some of the numbers that we are looking at on our screen in terms of Illinois Basin prices would suggest someone is transacting in the low 30s? Where are you seeing prices, if you had to go out today and contract good amount of volume for 2018? Where do you think prices would come in?

Brent Bilsland
Well, we have priced tons into 2017. I think that's reflected in our price deck in our 10-Q. And you know, I think in general that we feel confident that prices that we have sold coal for in 2017, we will be able to sell coal for in 2018, and the market is much healthier than it was a year ago. There is…I am not going to say there is a shortage, but the market is much stronger from a gas perspective from an export perspective, you know, the US dollars continue to fall, and that continues to help improve the export market. So again, we never state prices, but hopefully that helps…give you a general feel for where we are at. I will say in general, that the Indiana interior market has been stronger than the River market.

Lucas Pipes
Got it. Remind me, what are your export targets for this year? I don't think, it makes much of…it's not as an important driver for you guys, but just in terms of what your exposure is. Could you give us a refresher?

Brent Bilsland
We never exported a pound of coal with some close a couple of times. But I think what's important for us is that our competitors have exported coal. Transportation wise, it hasn't been our best netback through the years. But we see that sucking up tons that compete in our local market. So all ships rise with the rising tide, so we like seeing, you know, to kind of go back to that 2008, 2009 period, 20 million tons of surprise exports doubled our market. We didn't export a pound of coal that year. The coal pricing went from $30 to $60 in a couple of month window. It was all driven by exports. So that's why we keep a close eye on that because we may or may not make export sales, it definitely has…it definitely is a factor on our market.

Lucas Pipes
Great. Well, that's very helpful. I appreciate it. Good luck.

Brent Bilsland
Thank you.

Operator
Next question comes from…Again if you have a question, please press "*"then "1." Next question is from Tom Sleeter with Total Clarity Wealth Management. Please go ahead.

Tom Sleeter
Good afternoon everyone. In the past, you had mentioned that you've had some opportunities in the Southeast; I believe the utilities in Jacksonville and Orlando. With the extra capacity you have, are you continuing to pursue opportunities in that market or perhaps some other markets that you can serve efficiently even with the higher freight costs?

Brent Bilsland
Yes, I mean, the Florida market has been a very good market for us. We sell to multiple customers there now. And we have had…we currently are undergoing tests burns with a couple of new customers as we speak. So we are always looking for new markets to sell our product to. It's very much on our mind that we are running at 60% of capacity. It cost us money every day to hold that capacity idle. And we do so because we feel there is going to be opportunities for us to be able to place that coal in the very near future. So we are not paying you know, $6 million, $7 million a year to hold idle capacity just because we are in love with the mine. We are doing it, because we feel that there will be opportunities in the future to bring that asset back online.

Tom Sleeter
Okay and you answered [multiple speakers].

Brent Bilsland
On that point, I think part of what makes us special is, if we are successful on our plan of getting that mine back online, I mean, that's a pretty large revenue increase for our company. And it's something we can bring on rather quickly.

Tom Sleeter
Okay

Brent Bilsland
So that's the growth…that's part of the growth story of Hallador.

Tom Sleeter
Okay, excellent. You mentioned that you weren't doing any exporting, but you do own that export terminal. Are you able to lease the use of that terminal to others, so you get some revenue coming in from an otherwise idle asset?

Brent Bilsland
So we own some Summit Terminal, it's not…it's a dock on the Ohio River it doesn't necessarily have to go to export. We have purchased that for other reasons that, quite frankly haven't materialized. The dock does some other outside business and basically breaks even.

Tom Sleeter
Okay.

Brent Bilsland
So as far as…if we were to export coal, I think we would rail direct to the east coast. I think that would be the best fit for us, and we do look at the…

Tom Sleeter
[Multiple speakers], Ohio and Mississippi?

Brent Bilsland
Yes.

Tom Sleeter
Okay. Well, thank you. I appreciate it.

Brent Bilsland
Thank you.

Operator
To ask a question please press "*" then "1." Next question comes from Arthur Calavritinos with ANC Capital. Please go ahead.

Arthur Calavritinos
Hey guys. Yes, I just…I think I lost this on the…I am trying to read to the Q. How much debt did you get…I see, what it is for the six months. You took down 13…prepaying $13 million of debt. Are we running around like $6 million a quarter or something like that, to think about it?

Larry Martin
Yes, $6.6 million a quarter is what we've paid.

Arthur Calavritinos
Okay. And then when I look at the income statement, that then for the June 30th, you had $3.3 million of interest expense. So sequentially, I mean, if you keep on paying debt, that's going to be coming down at a pretty good rate, right? If I have to think about it, and particularly versus last year, too, I mean that's a huge drop, right? So there is the three goals like the 3, 2, 9, I don't have anything in front of me just to calculate it right now. But I mean is that how I am thinking about it or how do you think about your interest expense as you move forward

Larry Martin
Well, I mean, our interest, we are hedged at about 5% rate Arthur. And so we are paying $6.6 million a quarter. So as that…as we paid down the debt, our interest will reduce 5% rate…$6.6 million.

Arthur Calavritinos
Okay, got it. Alright, so it should be interesting for the fourth quarter. And the other thing is, I've been on the call with a few of the other call guys, and you guys coined the term first, but the term was the utility guys are playing the short game, and I butchered it a little bit. But they are playing the market short. So basically, with these guys, the way…I am trying to think the way the utility guys are thinking is, they think there is enough hydro carbons, whether it's nat gas or

coal out there, so they are like, you don't have to worry about this stuff, we can get all we want when we need or is there something else going on in their businesses that may be affecting how they order things, because I mean, I would rather order like as much coal as I could at today's prices. You know what I mean?

Brent Bilsland
Yes, I think the issue for the years' coal is a very consistent base load fuel. And so, burn projections at the utility were fairly easy to predict. As natural gas has become a greater competitor there's times throughout the last several years where natural gas production has increased. The storage of natural gas really hasn't significantly increased. And so when there's a hiccup somewhere in the demand for natural gas, it has to price down to a point where it displaces something. So…and that is…gas is basically trying to spill into the electrical market. So because of that, utilities have their predictive models on how much power they are going to generate going forward in the year have become less clear. And so, also you had a declining market demand at the same time.

So those two factors have allowed the utilities to say, you know what, we are just going to play it on the short side and the market has been oversupplied, so we will be able to buy our need. At some point in time, the market will overcorrect and you are going to see utilities get caught short. We thought that, that event was going to happen in January of this year, which is the reason we increased our inventory levels purposely. But then the weather turned out to be 75 degrees in January and February and that kind of subsided the tightness that we were seeing build in the market. That being said, we think that, as I've stated before, the market that we are in, gas levels…gas inventory levels are not near as high as they were a year ago.

Coal inventory levels are not near as high as they were a year ago, and yet, we've seen supply on the coal side come out of the market. We anticipate seeing more come out of the market this year, older production that has had legacy contracts and now they've got to come out and compete with lower-cost mines, such as ourselves. So, we think that, yes, the utilities are staying shorter. They still have big open positions. It makes everyone nervous when they see our open book and our competitors' open book, but that's just the new market dynamic. We don't seem to price out business on as long a period as we used to. But, we think there is a point, and we're not…hopefully, not that far from it, where the market will overcorrect, and we will go from an oversupplied market to an undersupplied market. I think we came very close to that this year. It didn't materialize. But, it's still not that far out of the realm of possibility. A little more export pulling coal out of the Illinois Basin or some weather events, I think it wouldn't take a lot to get this market to rally.

Arthur Calavritinos
It's funny because when you talk about models, the models are mathematical. So, when prices are low, they're playing the short game. But, you would think if it's a model like portfolio insurance in 1987, the stock market crashed. If prices go higher, they may want to go longer, you know what I mean, because models are models, the way they run it mathematically, I don't know it just is bizarre. Let me ask you something else. I've been on two calls. The guys have been complaining about CSX…basically about CSX, right? I mean, did you guys…if you guys get rail events, how is that translating your business? Just if you can't get it to a customer, and it's a rail event, is that…I mean, who's on the hook for what? How does that work with you guys?

Brent Bilsland
Well, we fill our coal loaded in the railcar. So, the second we load it into the railcar, into the trucks for that matter, ownership transfers to our customer assuming the coal within spec. The transportation is the cost of our customer. However, their problems become our problems. So with the call in the second quarter rail service, we're on the CSX. They've instituted dramatic change, and I think for good reasons, I think for trying to drive the cost of their business lower as we're trying to cost…drive the cost of our business lower. And if all of us are going to compete against natural gas, we've got to continue to strive to do so. That being said, there was a lot of dramatic change in the second quarter for the CSX, and performance was subpar. We've been delighted that in July and now in August, the performance of the CSX has been much more precise and really, really quite good. And we've seen in the last five weeks, our inventory levels come down significantly. So, we hope that service continues to be good. We've had rail interruptions. In past years, we've always found the way to work through them, and we will continue to do so.

Arthur Calavritinos
Okay. Good, got it. Alright, thank you.

Brent Bilsland
Thank you.

Operator
Again, if you have a question please press "*" then "1." At this time, there are no more questions currently in the queue. So, I'd like to pass the conference call back over to Brent Bilsland for any closing remarks.

CONCLUSION

Brent Bilsland
Thank you. So, to wrap up our prepared remarks, I will remind everyone that our sound balance sheet, our low-cost production profile, and our ability to quickly add 65% more production puts Hallador in a unique position to dramatically increase profits when demand picks up. In the meantime, Hallador's ability to generate positive free cash flow creates a great value for our investors. And with that said, I thank all of you for joining our call. Thank you.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.