Hallador Energy Company

Fourth Quarter 2017 Earnings Conference Call and Webcast

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CORPORATE PARTICIPANTS

Brent Bilsland - *President, Chief Executive Officer*

Larry Martin - *Chief Financial Officer*

Becky Palumbo - *Director, Investor Relations*

PRESENTATION

Operator
Good day and welcome to Hallador Energy's Fourth 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 a touchtone phone and to withdraw your question, please press "*" then "2." Please note, today's 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, Rocco, and thank you today for all of you joining us on our call. Our Form 10-K was filed with the SEC this morning. And if you haven't pulled out a copy, it is available on our website under the SEC Filings tab.

This call is being webcast live on our website and is available for replay, and a transcript will be available later this week. With me, on today's call, are Brent Bilsland, our President and CEO and Larry Martin, our CFO.

Our remarks today 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. Following our prepared remarks today, Brent will take calls in the Q&A.

So with that, I will turn the call over to Larry.

Larry Martin
Thanks, Becky. Good afternoon everyone. Before we get started with the quarter and the year I would like to define some definitions.

First of all, we define adjusted EBITDA as EBITDA plus stock compensation plus ARO accretion, and we define free cash flow as net income plus differed income taxes, DD&A, ARO accretion and stock compensation less maintenance CAPEX.

Okay, so let's get into the numbers. We had net income for the quarter of $21.4 million or $0.69 a share and $33.1 million or $1.08 per share for the year. We had free cash flow for the quarter of $12.9 million, $58.7 million for the year.

Adjusted EBITDA was $17.8 million for the quarter, $83.3 million year-to-date. We reduced our debt by $8.8 million for the quarter, $36.6 million total debt reduction for the year. We paid dividends of $1.2 million or $0.04 a share for the quarter, $4.9 million or $0.16 a share for the full year.

Our bank debt at the end of December 2017 was $202 million and our net debt, net of our cash and marketable securities, was $186.1 million. Our debt target for the upcoming year of 2018, we expect to owe about $165 million at the end of 2018. And our debt to EBITDA leverage ratio for 2017 was 2.4 times Sunrise's only net…EBITDA.

So now, I would like to turn over the call to Brent Bilsland, our CEO and Chairman of Hallador Energy.

Brent Bilsland
Thank you all for joining us today. Vic Stabio, our former CEO and Chairman, had a great saying. "Tell me the bad news, the good news will find me."

With that said, we are saddened to announce the passing of Vic on March 7th. Vic served as our CEO for 23 years and has presided over the board as chairman for an additional four. During Vic's 27 years with Hallador, he was instrumental in transforming our company from a financially challenged oil and gas exploration company to the successful mining company that it is today. Vic was a wonderful man, a dear friend and he will definitely be missed.

With that, I will now move to what Vic would call the good news. As we compare 2017 to 2016, there is a lot of good news to report. Our net income was $33.1 million versus $12.5 million for 2016. Now granted, $18 million was attributed to the tax act, but without the effects of a lower tax rate, lowering our deferred liability, net income is still $15.1 million versus $12.5 million for the prior year.

Revenues did decline year-over-year due to a reduction in our average sale price, but increases in tons sold help to reduce our production costs and led to an improved results in operating cash flow of $61.6 million for 2017 versus $60.9 million for 2016.

Our adjusted EBITDA was $80.3 million for 2017…$83.3 million versus $80.7 million for 2016. And adjusted free cash flow improved as well year-over-year, $58.7 million versus $58.3 million for 2016.

Yet another healthy year of free cash flow allowed us to reduce our bank debt from $238.6 million in 2016 to $202 million in 2017. This $36.6 million reduction in bank debt helped lower our leverage to 2.4 times debt to EBITDA and is well within our bank covenant…current bank covenant of 4.25 times.

In 2017, our liquidity also improved to a healthy $85 million versus $82 million in 2016. Additionally, we anticipate closing on the sale of our ownership in Savoy Energy, and oil and gas E&P based in Michigan for a net $7.5 million here in the first quarter. These proceeds will be used to further reduce our bank debt.

As we look ahead towards the remainder of this year, we have reaffirmed our projected sales target of 6.8 million tons for 2018. This represents an increased sales volume of 4% over 2017 and 8% over 2016.

The addition of our new Princeton loop, a truck to rail facility is helping grow our sales position allowing product to find its way to new markets on the Norfolk and Southern railway. We expect the Princeton loop to be fully operational in the second quarter. Thus, we expect 2018 to trend similarly to 2017.

Our average coal price is expected to drop roughly $0.80 a ton. However, increased sales volume should help us reduce and/or maintain our cost structure, creating plenty of free cash flow to fund our maintenance capital expenditures, pay dividends and continue to reduce our debt.

We expect the export markets to continue to be strong this year. While we may not directly participate in this market, strong exports help us indirectly with new domestic opportunities as evidenced by us shipping to two new customers in 2018.

Last month, Hallador invested $4 million in Hourglass Sands LLC, a frac sand mining company in the state of Colorado. Hourglass Sands, currently controls a permitted sand reserve near Colorado Springs. We expect to truck shipments to customers in the BJ Basin this summer. To our knowledge, this is the only permitted frac sand mine in the state of Colorado. We hope to be a part of the industry trend of switching to locally produced sands versus frac sands produced a thousand miles outside the basin.

We feel that frac sand mining is well within our core competency, exceeds our investment criteria and though we do not expect it to be profitable in 2018, we believe Hourglass can be…can meaningfully contribute to Hallador's earnings in future years.

So with that said, I will open up the call to questions.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your telephone keypad. If you are using a speakerphone, we ask that you please pickup your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press "*" then "2."

Today's first question comes from Lucas Pipes of B Riley FBR. Please go ahead.

Lucas Pipes
Yes, thank you and good afternoon everybody. And first of all, I wanted to add my respects to Vic. I feel very fortunate to have met him and see him as a manager and as a leader, so I am very sorry about the bad news. On my first question, I wanted to follow-up on Illinois Basin dynamics, we hear at the tailwind of earnings, a few of your peers have reported, some of them have commented on the very competitive, domestic, market dynamics, and Brent I wanted to get your perspective on that, and how you see the domestic market shaking out at this time?

Brent Bilsland
Well, it is competitive; we are seeing more tons go to export than in years past which has created some new opportunities for us. I think as you look at us and even our competitors, volumes in 2018 look to be higher than in 2017 and perhaps even in 2016. So as we look at the landscape, the trend that has happened as we have seen production come offline, both in Indiana and in other states in Illinois basin. And I think as a result of which you know, with the demand to export, but also as to some of the supplies coming offline, more mines are running at higher capacity factors. So in my opinion the market is less over supplied than it has been in years past.

Lucas Pipes
That's interesting and helpful. Thank you. Maybe, I will come back to the coal side. But very interesting announcement you made regarding Hourglass. And I wondered, if you could give us

a little bit more color as to ramp-up of this sand capacity. And also if you have a good idea of what the specs are from the mesh size, and then also the contracting strategy that you envision for this new asset. Thank you.

Brent Bilsland
Well, it is…this is still very new. We just made this investment roughly 30 days ago, but we are still working on what we envision right now as we've got a permitted reserve and we would look for a third-party to process that sand on our behalf, and we are still working on what exactly that's going to look like, once that's nailed down, we've had preliminary conversations with customers, and we have a feel for what we think they want to accomplish and those discussions will intensify here probably next month.0

So tentatively our schedule is to ship, test shipments in 2018 and then we would look to see what the relationships look like longer than that. To us, what we think is…what was the trend that we are seeing in the industry is it seems like most of the shale plays are using greater volumes of sand and willing to accept lower qualities. And that has kind of led to a transition of people purchasing sands that are locally produced versus sands that are produced a thousand miles away. So at the end of the day, this really is a transportation play. That's the advantage, is that we're thousand miles closer to market, and then it costs something to go a thousand miles. I am not sure if that answered all of your questions.

Lucas Pipes
Yes, that's helpful. That's helpful. Maybe one follow-up on the sand side and that's…In terms of the size of this asset are we…should we be thinking a million tons less than that more maybe up to 3 or 5 million tons, but…what's a good zip code to think about from a size perspective, I know it's preliminary, but kind of your first impression.

Brent Bilsland
Yes, I think part of what we are trying to gauge is how much of our product will the market accept. So I think for starters, somewhere in that 800,000 to 1 million tons is probably the zip code to think about here for next year. I think in 2018 we're really just going to look like a test shipper with smaller volumes and getting comfortable with what the customers would like to see.

Lucas Pipes
Okay. That's very helpful. Thank you. And maybe to turn back to the coal side one last question…

Brent Bilsland
To follow-up one more thing there.

Lucas Pipes
Yes.

Brent Bilsland
If we…as time goes on, if we decide that the market can handle more of our product then we will be looking to build and expand facilities to take that volume up to 2 or 3 million tons if the market can handle it. But we are still trying to determine that, and that's why we say down the road we think this is something that could be very meaningful to our earnings. Just looking at the transportation advantage and what the volumes could be.

Lucas Pipes
Does the sight of access to water or is that not necessary?

Brent Bilsland
Well, right now we will be looking to go through a third party that already has an existing plan. So they already have water. If we were to build something new, we would have to secure properties that…we would have to secure water rights, which is just a hurdle that we'd have to cross.

Lucas Pipes
Okay, thank you.

Brent Bilsland
And these are processes that are ongoing, so.

Lucas Pipes
Got it. To turn to back to the coal side, what are your latest thoughts on production…both production cost, other mine costs as you look out over the course of 2018 and then also beyond?

Brent Bilsland
Well, I think our cost structure is going to look very similar to 2017. One hand we are going to run more tons which is typically beneficial to our cost structure. On the other hand, we do have some inflationary pressures such as labor and steel. But if I had to place a wager, I would say our, I think our cost structure has a better chance of being lower than 2017, just due to the additional volumes that we anticipate running.

Lucas Pipes
Got you.

Brent Bilsland
And then holding idling costs for…

Larry Martin
Carlisle and Prosperity it…there will be…we are estimating 5 million, Lucas. The last quarter they were lower than that pace, but there is things that come up and we are estimating $5 million which we brought down over the last two years quite significantly.

Lucas Pipes
Yes, I want to say, I remember time when it was still $9 million or so.

Larry Martin
And I misspoke, there it is $6 million we are estimating for both not…its $6 million for the year.

Lucas Pipes
Okay, alright. Great, well guys, gentlemen I really appreciate it and best of luck this year.

Larry Martin
Alright. Thank you, Lucas.

Operator
And ladies and gentlemen, once again if you have a question, please press "*" then "1" at this time. Once again, that's "*" then "1" if you have a question. And as a reminder, ladies and gentlemen, that's "*" then "1" if you have a question. Please hold, while we poll for questions.

And our next question comes from Michael Sepulveda of Meraki Advisors. Please go ahead.

Michael Sepulveda
Hi, I appreciate you taking my question. I just have one, given the Hourglass announcement and one of your competitors' comments around investments in energy and oil field service companies. What should investors be thinking about in terms of consolidation within the Illinois Basin?

Brent Bilsland
Well, I think that we have seen a lot of consolidation. And I think we'll continue to see more consolidation. And I think, if you look at the State of Indiana, three or four years ago there were seven or eight producers, and today there is four principal producers. And if you look at some of the West Kentucky markets, those have basically consolidated down to two large players and one or two smaller ones. I think that's a trend that will continue. I think all of us…well I can't speak for the others, but I think for us is…we are a mining company that's our…lot of our knowledge base. It is our knowledge base. And so, when opportunities come along that we think look, like Hourglass has that we think have the potential for an above average return on investment and fits 80% of the skill-set is what we are doing today. It definitely have some nuances that are particularly sand versus coal, but we are capable of learning those nuances and hiring expertise to fill in our gaps. So we are excited about what we think we found. I don't know, if that takes away from our coal position, we are still very much interested, I mean, we've purchased Vectren Fuels in 2014, we purchased some of our other competitor assets in 2016, that doesn't mean we wouldn't be interested in doing that in 2018, it's just we have to find the right assets at the right price. And but today, we are very excited about what we found in Hourglass Sands, and think that return on investment we think could be above average. So that's a decision we decided to make.

Michael Sepulveda
Excellent, thank you.

Brent Bilsland
Yes, thank you for your question.

Operator
And ladies and gentlemen as a final reminder, if you would like to ask a question, please press "*" then "1" at this time. Once again, that is "*" then "1" if you have a question. Showing no further questions. I'd like turn the conference back over to the management team for any closing remarks

CONCLUSION

Brent Bilsland
Well, thank you everyone for taking the time to listen to our call. And Lucas, I appreciate your kind words about Victor, he truly was a special man and friend. And as he says, we'll get back to work. So thank you.

Operator
And thank you, sir. The conference has now concluded and we thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.