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HNRG - Q4 2014 Hallador Energy Co Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen and thank you for standing by.

Welcome to the Hallador Energy 2014 yearend earnings conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time.

(Operator Instructions).

Please note, today's conference is being recorded.

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

Becky Palumbo - *Hallador Energy Company - Director - IR*

Thank you, Karen. Good afternoon, everyone and welcome to Hallador's 2014 earnings conference call. We filed our Form 10-K on Friday afternoon with the SEC. You can access it on our website under the SEC filings tab during this call.

This call is being webcast and will be available on our website, along with a copy of the transcript tomorrow afternoon. Management present for the call today is Brent Bilisland, President and CEO of Hallador Energy; Andy Bishop, CFO, Hallador Energy; Larry Martin, CFO, Sunrise Coal; and myself, Director of Investor Relations for Hallador.

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 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. The format for today will be a discussion from management followed by a question-and-answer period.

Brent Bilisland, our CEO will now discuss our year end results.



Brent Bilisland - Hallador Energy Company - President, CEO

Hi everybody. Thank you for joining our call today. We are pretty pleased with our fourth quarter results. Cash generated in the fourth quarter from operations was \$35 million, of which \$5 million of that was a one-time distribution from Savoy. We don't expect any distributions from Savoy in the near future other than tax distributions.

In the fourth quarter, our EBITDA was \$28.4 million, excluding Savoy and from one time Vectren charges. Annualized, that'd be \$113 million of EBITDA.

Our fourth quarter pretax income was \$10.3 million, but I think our biggest news for the quarter was our cash cost on our mining units were down to \$29.60. I think we've said previous to that that we felt we could get under \$30 a ton in 2015 and we thought fourth quarter would be a transition quarter and we were able to accomplish that in the fourth quarter, ahead of schedule.

We are quite pleased with our results at the mine and our ability to get our cost down and we expect that trend to continue. We've said in our K that we feel comfortable that 2015 our cash cost will be below \$30 a ton.

For CapEx, in 2015 we expect to spend \$37.6 million, of which \$11 million of that will be P we anticipate for coal properties and different developments. We'll disclose more about those if those transactions are completed. The big story also in the fourth quarter was debt repayment.

We paid down \$39 million in the fourth quarter. Our debt as of the end of the year was \$306 million. Today that stands at \$296 million and we are forecasting that we can get our bank debt down to \$250 million by year end. That would be fully \$100 million down from the day we closed the Vectren transaction. At closing of the Vectren transaction last August, we had \$350 million in debt.

Our leverage covenants as defined by our credit facility, our leverage was 2.73 times as of the end of the year. We are allowed to have three in a quarter that will step down to three in the second quarter of 2015 and step down to 2.75 allowable leverage by the end of this year.

But again, as measured December of 2014, we are already at 2.73, so we are already below our lowest leverage ratio at that time and we anticipate paying down like I said debt from \$306 million to \$250 million end of year 2014, end of year 2015.

On contracts, our volumes did drop a little on contracts from what we expected. That was due to lack of performance out of the railroads. So we shipped less tons than expected in the fourth quarter.

However, most of those tons happened to be lower priced contracts. So our pricing improved a little bit in the fourth quarter. We expect those lower priced tons to get dragged into 2015 and be delivered in the first quarter of 2015.

For future contracts, 2016, 2017 and beyond, we are currently in the middle of several price reopeners and a couple of different RFP bid solicitations, with multiple customers for multiple year business. So we are going to decline to comment regarding market pricing and strategy.

We've got a lot going on and we just don't want to tip our hand to our competitors, or quite frankly our customers of what our thinking is. So we are working on it. It's definitely a big priority as we try to book more business in the next year.

Again, circling back to unit cost, I think that's our big story of the quarter. If you look at third quarter, third quarter of 2014 versus fourth quarter of 2014, we were plagued by low mine recovery in the third quarter, poor transportation.

We still were wrapping up - we're completing the Vectren transaction which had a lot of our attention. We had new orientation for two thirds of our workforce. That's a big deal when they show up on day one and two fourths of our people didn't know or understand our company. So we had to bring them in to the Sunrise way of life.

In the fourth quarter, I think a lot of that all started to turn around. We implemented some changes underground at the new assets, which helped recovery improve. We worked on our worst plants, which helped recovery improve.

Transportation was better. I think that we are not where we want to be, but we are headed in the right direction. We think that more good things are coming as far as what our prospects look like. But for now, we are willing to say that our costs will be less than \$30 a ton in 2015.

The transportation in general has been better. In fact I would say in January it was quite good. February, first half of February was excellent. We've had a lot of snow here in the last half of February, which has fouled things up a bit, but March seems to be going on nicely as far as shipments go.

I think a lot of the problems that were plaguing the railroads, especially their service to us seems to have improved from 2014. So we are thankful for that. We also are shipping a third of our products via truck this year.

So that's a change for us and that seems to be going well, with the exception of weeks that we have eight to 10 inches of snow. That wreaks havoc on all transportation. But so far we feel good. We are a little bit behind on contracts just because of the weather, but there should be less snow in the forecast here in the coming months and we feel very comfortable that we get our shipments delivered this year.

So with that, we are going to open it up to questions from our participants.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions).

Our first question comes from the line of Lucas Pipes from Brean Capital.

Lucas Pipes - Brean Capital - Analyst

Good afternoon everyone. I wanted to follow up on your deleveraging plans and maybe even look a little bit past that. If at the end of this year we had about \$250 million, or you had about \$250 million in debt, on my number set it would be leverage ratio of just below two times and at that point, I think it might, maybe it would make sense to think about dividends, buybacks, M&A.

First, my question would be, how do you think about that? And then secondly, when you are to prioritize dividends buybacks or M&A, how would you rank those?

Brent Bilisland - Hallador Energy Company - President, CEO

I think we would P I think there are three primary areas right now that we are looking at of what do to with our excess cash flow. The first is debt repayment. The second is debt repayment and the third is debt repayment.

We are pretty a low risk management style. I think priority one for us is debt repayment and at \$250 million of debt we still feel uncomfortable with that amount. We would like to focus on getting it down lower than that.

And then once we've had our debt say down in the below \$200 million, then I think would start to look at improving our dividends. We haven't had a lot of discussion about this with the board because quite frankly we are so focused on debt repayment. We haven't talked a lot about increasing dividends.

As far as M&A, I think that for the right assets we are always interested. It's harder to do now because we do have more debt on our balance sheet. Going into the Vectren deal we were net debt free and that's a happy way to live life. That's our goal to get back to that. We feel that we've got low cost assets.



We feel we're in the right basin, in the right place in the right basin. The only way we can screw this up is getting over levered. Sure, you're going to have bad quarters here and there. Pricing is going to be high, be low, but at the end of the day; the only way we can really screw this up is to be over levered.

Lucas Pipes - *Brean Capital - Analyst*

That's helpful. Maybe to follow up on one point there. Do you have a target leverage ratio or is ultimately the goal \$200 million and then you reconsider? How should we think about your capital structure, your preferred capital structure?

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

Our preferred capital structure is zero debt. Now, like I said I think we have to be below \$200 million before we really start considering hey, is this a good time to raise the dividend? As far as what's the appropriate leverage ratio, right now we are just focused on staying well below what our bank covenants say we need to be at.

Lucas Pipes - *Brean Capital - Analyst*

That's helpful. Thank you. Then maybe to follow up on the cost side. Congratulations on a very nice performance in Q4. I was wondering as it relates to 2015 guidance, it seems like you're more or less there already and you mentioned in your prepared remarks that you are hopeful that there is further improvement. Could you maybe explain what the upside potential is in terms of getting cost well below your current 2015 guidance and the reason why you kept the guidance unchanged?

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

Right now we have one quarter of data and we would like to under promise and over deliver for all those involved. But I think in general that in the fourth quarter -- the full quarter started in October. We basically took control of our new assets on September 4.

We still, even to this day, our employees -- two thirds of our employees are still learning the Sunrise way of life and learning how we want to operate things. I just think there's room for improvement there. I think that our people get in the rhythm and know what we expect and we do things a little differently and I think that culture will get better. It will continue to improve.

Additionally in January, we made a wash plant modification. We put some new equipment in at Carlisle and we've seen an improved recovery at that mine pretty dramatically. That's going to help our cost structure and we are pleased with those results. Again we hate to go out there on a limb too far and say our costs are going to be several dollars lower because it's going to depend on rail service. It's going to depend on truck service.

We feel pretty good about both currently, but we want to continue to see and make sure everything gets shipped. In general, we think things are headed in the right direction and we think costs can get lower. We are just trying to be conservative on what we tell everybody we can do. We don't like it when we say, it's going to be below 30 and it's above.

Lucas Pipes - *Brean Capital - Analyst*

Okay. I appreciate that and I'm sure you're ...

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

Because then these analysts ask me why.

Lucas Pipes - *Brean Capital - Analyst*

Yeah, I would probably be the first one. Is there anything on the horizon that you could see that costs would be materially higher? Any risks that we should be watching out for over the course of this year?

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

At this point, it's just execution and I don't see anything within Sunrise that's going to lead to a higher cost structure. The only thing on the horizon in my mind that could lead to above 30 is if the shipping just fall flat.

If the railroads don't perform like they did last year, I think we have a problem. I think our costs will be higher. I think that risk is lower because we've seen the railroads put a lot of money in their infrastructure. I think volumes are down a little bit for all commodities.

So I think that that has helped them perform. They're not moving as much volume so therefore a higher percentage of coal volume is getting shipped. If that would change with oil at \$50, I don't think as much oil is going via rail and I think a little less coal shopping.

I think with those factors, the rail service has gotten better and I think it will stay there. Really before 2014, we never had rail issues. I mean you might miss a train here and there, but last year was just -- they got behind and they just never got caught up and they seemed to have gotten caught up. I think there's a whole host of reasons for that, which I just walked through.

Hopefully they do their end of the deal. I feel comfortable that Sunrise can perform. We know we bought low cost assets. We know that and we had theories as to what we could do to improve recovery, what we could do to mine more coal per man hour and those things have come true. We feel really good about, we did what we said would happen and in fact we did it on a timeframe that was ahead of when we said it would happen. So we're quite happy.

Lucas Pipes - *Brean Capital - Analyst*

Good luck for the rest of the year. Congratulations again on the good work. I'll jump back in queue. I appreciate your answers.

Operator

Thank you. (Operator Instructions).

Our next question comes from the line of William FitzGerald from Windcrest Partners.

William FitzGerald - *Windcrest Partners - Analyst*

Hi there and thanks very much for taking my question and congratulations on the improvement in your results. I was wondering if you could speak a bit about the competitive landscape. I know you don't want to talk about pricing ongoing negotiations, but maybe you could talk a bit about how many customers and what the demand from those customers is for whom your coal is the most cost advantaged option and what the addressable opportunity is within that groups of customers?

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

I don't expect our customer base to change dramatically. We've been shipping mostly to the same eight customers for quite some time, which tells you that they like our coal quality and that our transportation to those customers works.



The coal work to transportation work and really we are right in the middle of bidding those processes and finding out who is going to buy how much coal. That's not going to be decided in a day. That's going to be decided over the course of this year and quite frankly utilities are struggling a little bit to figure out what their needs are.

When gas starts competing with coal and when you get down into that \$2.50 range for natural gas, it becomes very difficult even for the Indiana utilities to figure out what their burns are.

It's hard for them to tell us what they need and that's the process we are all going through right now. Everyone is buying their base books and then we expect customers will probably circle back later in the year and say okay, now we feel more comfortable, our crystal ball is a little clear as we go out.

We expect to book a few deals here in the next two, three months and then I think you'll see a lull and then I think come this fall again you'll see another round of purchasing. In general, that's the timing. Again we don't expect a lot of new customers, maybe one or two.

William FitzGerald - *Windcrest Partners - Analyst*

I guess I'm asking a longer term question. If you look at the scrubbed plants where your mines are the closest and cheapest source of coal, what is the tonnage demand from those plants and given that your customers want to have multiple sources, what is a realistic opportunity for you at those plants?

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

We are shipping 9.3 million, 9.4 million tons this year. So I think that's obviously a realistic demand because that's what we are doing. The Harding Street plant will go away sometime next year. That is \$1 million, \$2 million of business that we'll be looking to replace.

All our other customers, the other plants, even IPL, I mean the Harding Street plant is slated to close. That's the headline everybody reads. What they don't read is they're spending a couple of hundred million dollars in the Petersburg plant to upgrade it to make sure it keeps running.

There's still a lot of plants out there that are going to keep ruining. In fact I think the growth potential for the base and if we want to go a little longer term out, if you are saying you want to look at two years out, I think the growth potential is still the Southeast and we talk with the rail roads. They tell us hey, we ought to be shipping more Illinois basin coal to the Southeast than we are.

The issue is we've got central Appalachia and even Northern Appalachia selling coal below cost trying to stay in business and that has delayed the transfer from the Illinois basin low cost structure from shipping more coal to the southeast.

You're going to see that transition. At the end of the day and the long run, the lowest cost producer wins or the lowest, I'm going to say, third the producer wins because no utility wants one supplier. They want a minimum of three.

So that has happened to some degree, I mean right now we ship 15% of our business out of the state to the Florida market. We think that's a higher percentage three years from now, two years from now. It's kind of fuzzy when that transition happens, but I think it happens a little bit every day.

The question is going to be is how long are some of these central App producers that are losing money going to hold on? I think the answer to that is, when they run out of capital they'll be out of business and when that happens the Illinois basin is going to grow dramatically.

William FitzGerald - *Windcrest Partners - Analyst*

Okay, thank you very much.



Operator

Thank you. (Operator Instructions).

We have a follow up from the line of Lucas Pipes from Brean Capital.

Lucas Pipes - Brean Capital - Analyst

Hello again. I just wanted to follow up on what's going on in the market right now. Obviously there's gas prices as you pointed out being in the \$2 range. There is a lot of concerns about switching and how this is going to impact the various basins.

Could you just maybe give us an update on how you see the situation of your customer plans at this time and then how worried you are in terms of things potentially deteriorating?

Brent Bilisland - Hallador Energy Company - President, CEO

There's a lot of questions in there. Just to kind of reiterate, I think if P and you only have two tiered gas pricing now. You've got your WTI, but what we saw here in the last month in Indiana, we had a lot of pipeline constraints. So when it got really cold a couple of weeks ago, the NYMEX gas was trading at \$2.70 and gas at the utility in Indiana was \$7.20.

And it's just, a lot of these plants have not purchased firm capacity. Some capacity starts to get tight as plants quickly go out of the money. Indianapolis Power and Light told us they ran oil generation in front of gas generation there for a period of time because they didn't have pipeline capacity. So gas is definitely a problem for the coal industry. It's a bigger problem out east.

It's less of a problem in the Midwest, but there are times it's a problem. And if you are a utility that has purchased a lot of high priced coal, so you are at the top of the pricing curve, so you're one of the last coal plants to dispatch into MISO and then all of a sudden gas prices start dropping because of whatever issue, those plants all of a sudden don't dispatch at full load.

They still dispatch. They just don't dispatch all the time. So if your utility has got some of those assets on the bubble and you are trying to figure out, all right, how much coal do I buy for this year? That's really a difficult thing to forecast because their forecast changes every couple of weeks.

So they don't know if they're long. They don't know if they're short. And so they struggle to make buying decisions until they can get that figured out.

And I think you've got a few utilities out there doing that right now where they're not sure if they're long or if they're short. So we are not going to buy anything until we figure it out. And as time goes on, they'll figure it out.

I think the biggest problem to the industry right now is you've got a lot of eastern production that is not cost effective, but when you are dying you take your time. And they're going to sell at a loss and sell at a loss and sell at a loss until their credit runs out. And when that happens, you'll see a big correction in the market. I don't think anybody has a great feel for when that is. On the supply side, in the meantime you've got gas.

I think all the gas producers have pulled in their reins as far as drilling, but it takes a little time for those gas decline curves to kick in. Most of what I read says okay, we are going to see a lot of gas start to pull back next year, but its P there's a lot of different theories out there. So Lucas, I'm not 100% sure what your question was. I'm not 100% sure if I answered it.



Lucas Pipes - *Brean Capital - Analyst*

I think you got it. No, this is very helpful. Maybe a quick follow up. I understand you are in the middle of negotiations and everything, but if you were to price and commit the tons that you were referring to in your prepared remarks in terms of being in negotiations, what percentage of your -- if those fields close, what percentage of your 2016 production would be roughly under contract?

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

I'm not going to answer that.

Lucas Pipes - *Brean Capital - Analyst*

All right, that's fair enough. Okay, thanks for taking my follow up question.

Operator

(Operator Instructions)

Our next question comes from the line of Bryan Bergin from Cowen and Company.

Bryan Bergin - *Cowen and Company - Analyst*

Good afternoon. Can you guys just talk about CapEx over the next two to three years, if we should expect any material changes to sustaining CapEx levels?

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

No. Traditionally we spent maybe \$3.50 to \$4 a ton on what we call maintenance CapEx. And then like this year, we are going to spend around a little over \$26 million, \$27 million on maintenance CapEx.

We've got another \$11 million slated for some property that we think we will get bought. Maintenance CapEx probably down a little bit this year as far as on a per ton basis just because we did get a lot of excess equipment in the Vectren transaction.

It's more towards the \$3 a ton, but I would say looking out in 2016, 2017 and beyond, I would use \$3.50 kind of as a good plug on where we are going to be on maintenance CapEx. And then as far as the properties, if we see something interesting we are going to buy it. If not we won't. It's hard to focus or forecast much there.

Bryan Bergin - *Cowen and Company - Analyst*

Okay, and then just as far as Bulldog goes, any update there? I saw on the K you mentioned an expectation of permitting. Is that a second half 2015 expectation?

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

We've had our formal hearings and the state has to give us a response I think next week. They did call and asked for P we have granted them a couple of weeks extension to that. We think we are really close to having their comments back.

We suspect that they will ask for some modifications here or there. We'll make those modifications and re-submit to them. How long they take to look at that is a little uncertain. The State of Illinois, I think the powers that be kept the permitting division underfunded by design. So they've been pretty short staffed for a long time.

They've got a new governor over there who's shaking things up quite a bit. But he is, in his budget, whether or not it will pass or not, we're not sure, but he has allocated more funding for the permitting department of the state of Illinois. We feel confident we are doing to get it this year. Does that come in May or does that come in July? I really don't know. At this juncture, I don't think -- I think we'll get it this year and we'll be happy with that.

Bryan Bergin - *Cowen and Company - Analyst*

Okay and then just last one as we think about pricing in 2015, what you guys have, your average price per ton around \$44.68. Is there any lumpiness quarter to quarter or is that relatively steady for your contracts?

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

I think it's relatively steady with the exception of like we said in the fourth quarter some of our lower priced business got dragged into the first quarter of 2015 from 2014. That provides a little lumpiness, but I think we are pretty consistent.

Larry Martin - *Sunrise Coal - CFO*

This is Larry Martin. Our scheduling is consistent. We could get lumpy just based on customers, their own transportation issues and scheduling. Right now it's scheduled to all be ratable so it should be ratable. But that it's coal mining. It always changes. So it could get a little lumpy, but right now it's scheduled not to be.

Bryan Bergin - *Cowen and Company - Analyst*

Okay, I appreciate that. Thank you.

Operator

Thank you. (Operator Instructions).

And I see no further questions from the phones at this time. I would like to turn the conference back to management for any closing comments.

Andy Bishop - *Hallador Energy Company - CFO*

This is Andy Bishop. In our last call we talked about SG&A and we've updated that forecast. For 2015 we are now using \$15 million for SG&A. And as we pointed out in the 10-K, our tax rate that we expect to have for 2015 is going to be in the 25% range.

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

I appreciate everybody taking the time to call in today and we look forward to hopefully having some good results this year. I think we are headed in the right direction and we'll get back to work. So thank you.



Operator

Thank you. Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may now disconnect.

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