Hallador Energy Company

Third Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Brent Bilsland - *President, Chief Executive Officer*

Larry Martin - *Chief Financial Officer*

Rebecca Palumbo - *Investor Relations*

PRESENTATION

Operator
Good afternoon, and welcome to Hallador Energy's Third Quarter 2017 Earnings Conference Call. 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 “*” and then “1” using a touchtone telephone, to withdraw your question, you may press “*” and “2.” Please note, today's event is also being recorded.

I would now like to turn the conference call over to Ms. Rebecca Palumbo, Investor Relations. Ma'am, please go ahead.

Rebecca Palumbo
Thank you, Jamie. Good afternoon, everyone, and thank you for joining us on today's discussion of our third quarter 2017 results. I hope you have all had the opportunity to review our third quarter earnings release and our Form 10-Q, which was filed this morning with the SEC. This event is being webcast live, and you'll be able to access the replay of this on our website.

As a reminder, 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 maybe required by law.

With me today are Brent Bilsland, our President and CEO and Larry Martin, our CFO. Larry will begin with a review of our operating results followed by prepared remarks by Brent. Brent and Larry will take your questions afterwards. With that, I turn the call over to Larry.

Larry Martin
Thank you, Becky. Today I want to go over the review of our operating results. Net income for the third quarter was $3.9 million, which resulted in $0.13 a share. We had $11.7 million of net income year-to-date, or $0.38 a share for the nine months. Our free cash flow, which is defined as net income plus deferred income taxes plus depreciation, depreciation and amortization plus ARO accretion and stock compensation, less maintenance CAPEX. Our free cash flow was $15.3 million for the quarter, and $42.5 million year-to-date.

Our adjusted EBITDA, which is defined as EBITDA plus stock compensation, plus ARO accretion, was $21.2 million for the quarter, $65.5 million for the nine months. We reduced debt by $14.8 million in the quarter and $27.9 million year-to-date. We paid dividends in August of $1.2 million, $0.04 a share and year-to-date we paid $3.7 million or $0.12 a share.

Our bank debt as of September 30th was $210.7 million. Our net debt was $196.7 million. Our debt target for the rest of the year is $202 million to $207 million of bank debt and our debt to EBITDA ratio which is our leverage ratio required for our bank and is a sunrise-only calculation was 2.42 times at the end of September.

I would like to now turn over the…to go over the general statements and results to Brent Bilsland, our CEO.

Brent Bilsland
Hi, everyone and thank you for joining us today. I am happy to report that Hallador has posted yet another respectable quarter. When we compare our company-wide cash cost for the first nine months of 2017 versus the first nine months of 2016, we have successfully lowered our cost structure by 9%. These reductions in our cost structure has enabled Hallador to generate $42.5 million of free cash flow for the first nine months and $50.3 million for the third quarter. We had utilized our cash to de-lever our balance sheet and invest in our business.

First let's discuss de-levering. In the first nine months, we reduced our bank debt by $27.9 million, of which $14.8 million was paid down this quarter. This is important as we have now lowered our debt to EBITDA ratio to 2.42 times. As long as our leveraged ratio remains below 2.5 times, the interest rate we pay is reduced to LIBOR plus 300 basis points versus LIBOR plus 350 basis points. The step-down in interest rate equates to roughly a million dollar savings over a year's time.

Additionally, in the quarter, we were able to increase our liquidity to a healthy $83 million at the end of September, and then focusing on the balance of our free cash flow, we've been investing in Hallador in our business. We believe at Hallador, you're either growing or you're dying and by this we mean you're either investing in your business or you are not. If you look back at our history in '14, we purchased Vectren Fuels. In 2016, we purchased reserves and contracts from our competitors. In 2017, we have invested in our wash plant making it more efficient. Last week, we completed our new elevator at the Oaktown 1 mine, which will help reduce our labor cost.

We anticipate delivery of a unit's worth of battery cars in just a few weeks, which will help further lower our costs per ton at the Oaktown mine. For several years, Hallador has invested and worked to continue to lower our cost of production, but we have been challenged by weak market that has limited our sales volume to roughly 60% of capacity. Thus, we are excited to announce that we have broken ground on a truck to rail coal-loading facility that will be located near Princeton in Indiana. This facility will include the ability to unload trucks, blend coals, load 135 car unit trains in four hours and store over 4 million tons of coal.

The new facility which we refer to is the Princeton Loop, will primarily serve utility coal plants served by the Norfolk and Southern Railway, once the rail facility is completed in the spring of 2018. We are excited about the development of the Princeton Loop as it enables Sunrise's low-cost production to access substantial new markets and better serve our customers.

As we near the end of 2017, we are very optimistic for our 2018 sales prospects. Current sales are approximately 4.3 million tons fully priced and with the addition of the Princeton Loop we expect to sell as much and potentially more in 2018 than our 2017 sales of 6.4 million.

Our optimism is based on several factors; we are currently on the shortlist of utility contract RFPs and engaged in sales discussions. We expect decisions for 2018 and may be longer term to be made relatively soon. We've also seen utility stockpiles decline in 2017 and utilities continue to execute their stay short procurement strategies. This will provide additional opportunities for spot coal sales in the coming months.

Natural gas prices continue to range between 280 and 320 per MMBtu which provides stable coal burns in our markets. Additionally, the export market for all coal basins has been very strong lately, and our current projections offer a strong 2018 export market. While this may not directly benefit Sunrise Coal, it certainly helps indirectly.

Additional announcements; on Friday, we announced that Larry Martin will assume the role as Sunrise's President from me and that Heather Tryon will assume the role of Sunrise's CFO from Larry. Larry will continue to remain as Hallador's CFO as well. These are not big changes in our company organization, as both individuals have been instrumental in our company's growth and success for several years, they have earned these promotions and our company is better off because they choose to be a part of our organization.

I will continue to be Hallador's President, CEO and Director. I will continue to be very involved in Sunrise Coal which remains, by far, Hallador's largest investment. These changes are about recognizing the outstanding performance of Larry and Heather adding depth to our management team in preparing our company for a period of growth.

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

QUESTION AND ANSWER

Operator
Ladies and gentlemen, at this time we will begin the question and answer session. To ask a question, you may press "*" and then "1." If you are using a speakerphone, we do ask that you to please pickup your handset before pressing the keys to ensure the best sound quality. To withdraw your questions, you may press "*" and "2." Once again, that is "*" and then "1" to ask a question. We will pause momentarily to assemble the roster.

And our first question today comes from Lucas Pipes from B. Riley FBR. Please go ahead with your question.

Lucas Pipes
Hey, good afternoon everybody and congrats, Larry, on the promotion, that's well deserved, that's awesome to see.

Larry Martin
Thank you, Lucas.

Lucas Pipes
So, I wanted to, Brent, follow-up a little bit on your commentary regarding growth. That's not something we are accustomed to hearing in the coal industry. And maybe just from a very high level, if you could share a little bit more about where you see the growth opportunity. Is this more Hallador specific or is this tapping into changes in the industry dynamics in the thermal coal market, specifically in the Illinois Basin? And then, of course, I am very intrigued by the investments in the rail load-out that you are working on. I wondered if you could give us a couple numbers around that, i.e., what is the investment in that facility. You may have said it, but I may have missed it but if you could share the CAPEX associated with it? And then also what you expect in term of returns be it from higher volumes or higher realized prices, I would appreciate your perspective then. Thank you.

Brent Bilsland
First, touching on the growth, I think that we are big believers in that. We talked about there are coal companies that have invested and there are coal companies that have just sucked all the

cash out of their business. We feel we are in the camp and that we have continued to invest in our business and we have continued to reduce our cost structure and we feel that puts us into an advantage to continue to make good returns regardless of weak market pricing.

The two changes I think that we fundamentally see are, we continue to see higher cost production come offline and as we look, I mean there is coal companies that are struggling. We have looked at a lot of them and at the end of the day, regardless of who buys them or whether they just go away, we see less tons being produced from those assets than have been produced in the past.

From our standpoint, we think that the rail facility, the Princeton Loop, which we are budgeting at $10 million facility, we view that as a game changer for us and in that there is a lot of demand that can only be accessed by the NS railroad and we have never had access to that market, starting in the spring of next year we will. So that gives us a whole new customer group to call upon and try to sell our low-cost production to**.**

Secondly, we have a lot of customers that say to us, well, we have some plants that are in the NS and we have some plants that are in the CSX and I have to be careful to only buy coal from you that are CSX served. This way now we had access to both the CSX and the NS. Customers could feel more comfortable buying larger blocks of business from us because they know that well, if I have problem with the CSX plan, I can always take the coal to the NS plant and keep our position where I want it to be.

So, with that, I think we have said for a long time what is unique about Hallador is, is that we are company that is operating at about 60% of capacity. We are hopeful that the addition of the rail facility will help us utilize more of our capacity going forward.

Lucas Pipes
That's very helpful perspective, thank you. To switch topics, your cost in the third quarter is a little higher than the year to date figures, so I think you also gave guidance for the fourth quarter that was somewhere between the two numbers, if I recall correctly. So, as you think about 2018 and how Oaktown is positioned on the cost curve and the improvements that you alluded to, what do you think is a good number to put in our model just for Oaktown coal? Thank you.

Larry Martin
Well, for...yes, for Oaktown coal, it is depending on the sales contract that Brent talked about coming in, but obviously I mean, if we do 7.2 million to 7.5 million next year with this Lucas, you have seen where our costs were in the first quarter, they were in the 20…below 25. You know at a 6 million ton level, you are more at a $28 cost structure for the year.

Brent Bilsland
In the third quarter, we just didn't produce as much coal shipments. Shipments were decent but our production slowed down, since the decision we needed to do to adjust inventory levels, so that's why we saw an increase in cost.

Lucas Pipes
And so, the cost performance will depend a lot on volumes. Is there any additional color that you could share with us regarding what you are…coal volumes to be at the high end of the range that Larry just mentioned, call it 7 million plus tons versus low 6 million tons? What do you think, Brent, is going to be the main driver outside of the whole…the high end or low end of that range?

Brent Bilsland
One more comment on cost, also in the third quarter we have, the 04^{th} of July holiday, which is a shutdown week. So that also helped drive our costs higher during that time period. As for overall sales, will we be at the higher end of the range or the lower end of the range, I think that we feel that we've fairly consistently, in the last couple of years here, have run in the 6, 6.5 range, and we feel that the market today is stronger than it was a year ago. Gas prices have been fairly consistent in the last 13, 14 weeks, kind of staying in that $2.80 to $3.20 range. Coal is in the money in Indiana at those prices. What's probably the biggest development is exports have really continued to be much stronger than I think our sales and others have anticipated. And we haven't been exporting coal, but the Central App coal, a lot of that has been going to export. Some of the NAP's been going to export. Some of the Illinois Basin coals that hit the river well have been going to export and it's just created a lot of tons that don't…that haven't gone to export in years past are going there now. So again, we are in our…we are right in the middle of our sales negotiation period. But to us, it certainly appears that there is a high probability we will ship more tons in '18 than we did in '17. And how much of a factor our rail loop will play in that remains to be seen, but it's certainly something that we think is opening doors for us.

Lucas Pipes
That's great to hear. Really appreciate all the color and best of luck. And thank you.

Brent Bilsland
Thank you.

Operator
Once again, if you would like to ask a question, please press "*" and then "1." Our next question comes from Arthur Calavritinos from ANC Capital. Please go ahead with your question.

Arthur Calavritinos
Hi, guys. Thank you. One question on the…two questions actually. On the debt, right, you did a great job paying it down, and I assume you are going to keep this facility for a while because I am looking at other coal company's price in the fixed income market, and they price it…and I'm sure you guys have…it must price at a much higher cost of capital. So, I am not sure when this thing matures, and if does, I think it might be '19, but I am not sure if that's right. Are you going to act to keep this piece of paper out there and extended, if you could couple of comments on that? Thank you.

Brent Bilsland
Well, currently our credit facility expires in August of 2019. We have worked very aggressively to try to de-lever our balance sheet, and I am very proud that we've got it down to 2.4 times. What we decide to do as far as…when will we refinance that, I don't know that we've made that determination yet. I don't think there is pressure on us.

Arthur Calavritinos
Yes, I agree. I don't think there is pressure at all. But I'm just saying, it's a great piece of paper when I look at the cost of capital that's out there for other coal companies there in a high yield market issuing paper. So, what I'm thinking is would the game plan be just to have extended whatever it is at the same…you probably get the same type of rate that's what I'm saying,

because when I look at what's going on out there, there is a lot of higher cost of capital on a fixed income side that's all.

Brent Bilsland
Yes, right. I think that as we get into the next year at some point in time, we will certainly sit down with our bankers and have those discussions about what the right game plan is. We haven't worked on refinancing to-date as we have plenty of runway and I think that we want to get ourselves positioned...kind of put to bed before we would have those types of discussions.

Arthur Calavritinos
Okay. And then on the…

Brent Bilsland
I agree with you. I think we have a good deal on our bank debt.

Arthur Calavritinos
Okay. And then, on the nat gas side, I am seeing a [indiscernible] delay here, but about 315 during a quarter of Jan of 18, I was checking on the coal company, how does the transmission mechanism work as gas and coal prices go up, let's see we get a $4 number this Jan or Feb, is it just the switching cap in first, so you are moving more volumes and then price follows, how...if you could walk me through that, so I can understand it better. And that's it, thank you.

Brent Bilsland
Well, I think that natural gas pricing determines how big the coal market will be nation-wide and then the coal market competes against coal. And so, right now, we have been in a period of time where the coal market has been oversupplied. But, we have seen a lot of correction in the past last 12 months from a coal inventory standpoint, from a natural gas inventory standpoint, we have spent most of the year with natural gas inventory levels being above five-year average and currently they are below.

Export market has certainly been very welcome. When we will see price appreciation, I think the issue right now is that most suppliers have a larger open position than they traditionally have, when we look at the market, we know that X amount of coal has to be purchased and we think that because of the quality and the cost structure and then now transportation flexibly that we offer our customers, we all think that we have a handle on roughly where our sales positions will be. Once capacity starts to get locked up as you move up and how much coal you are going to ship, I think pricing will rise and I think it's going to be a faster rise than it's been in years past just because there is fewer players. So, I hope that answers your question.

Arthur Calavritinos
No, and in the past, let's say like five years ago plus when you have like times when there was coal demand went up and gas was stable, it was really volume driven. What I am saying now is if we have a situation that's volume and price driven because of the capacity is less and overreliance on nat gas. It seems like if we have an up cycle in demand you may get it, or get it from volume and pricing it seems like, with a lag but versus five years ago or maybe you might just gotten more with volume? Would that be accurate or…?

Brent Bilsland
Well, again supply equals demand…

Arthur Calavritinos

Yes.

Brent Bilsland
Right, now I think because of the larger open positions pricing has yet...it's pricing has improved more than was four months ago, but it hasn't returned to the price levels was two three years ago yet. But, we are certainly keeping an eye on this because I think we have Central App prices move fairly dramatically in the last month, I think we have seen Northern App prices move pretty aggressively in the last month. And I think a lot of that's driven by API-2, seeing a fairly dramatic increase in the last couple of months and all of us, all ships rise on a rising tide and I think it will be moving in the direction of the Illinois basin, soon.

Arthur Calavritinos
Okay. Alright, guys. Thank you.

Operator
Once again, if you would like to ask a question please press "*" and then "1", to withdraw your question you may press "*" and "2." Ladies and gentlemen, at this time showing no additional questions I would like to turn the conference call back over to management for any closing remarks.

CONCLUSION

Brent Bilsland
Well, I have no further remarks. But I appreciate everyone joining our call and we look forward to what the future brings. Thank you for joining us today.

Operator
Ladies and gentlemen that does concludes today's conference call. We do thank you for joining today's presentation. You may now disconnect your lines.