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HNRG - Q3 2016 Hallador Energy Co Earnings Call

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### CORPORATE PARTICIPANTS

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

**Larry Martin** Hallador Energy Company - CFO

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

### CONFERENCE PARTICIPANTS

#### Operator

**Lucas Pipes** FBR & Co. - Analyst

**Arthur Calavritinos** ANC Capital - Analyst

### PRESENTATION

#### Operator

Good afternoon, and welcome to the Hallador Energy Company third quarter 2016 earnings conference call. All participants will be in listen-only mode. (Operator Instructions) After today's presentation there will be an opportunity to ask questions. (Operator Instructions) Please note that this event is being recorded.

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

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

Thank you, Denise. Good afternoon, everyone. Welcome to our third quarter 2016 earnings call. On Friday afternoon, November 4, we filed our Form 10-Q with the SEC, which is now available on our website under SEC filings tab. This call is being webcast and a replay will be available on our website along with the transcript later this week. On today's call will be Brent Bilisland, our CEO and President; and Larry Martin, our CFO. Following our prepared remarks, we will open the call to your questions.

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 or revise our forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by law.

I'll now turn the call over to Larry for the third quarter highlights, followed by comments from Brent. Larry?

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#### **Larry Martin** - Hallador Energy Company - CFO

Thank you, Becky and good afternoon, everybody. I just want to go over the review of our operating results.

For the third quarter, we had net income of \$4.3 million or \$0.14 a share; year-to-date, \$16.3 million or \$0.54 a share. Our free cash flow, which we define as net income plus deferred income taxes, plus DD&A, plus amortization of stock compensation, less maintenance capital ex was \$12.9 million for the quarter, \$42.6 million for the year.



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Our adjusted EBITDA, which we define as EBITDA plus amortization of stock compensation, was \$16.6 million for the quarter or \$68.8 million for the year. We incurred no debt in the third quarter and \$15 million debt for the year. We paid down \$11.6 million on our bank debt for the quarter, \$26.5 million for the year.

As you recall, we purchased Freelandville contracts and reserves in the first quarter, which was the reason why we incurred the \$15 million, but today we paid \$26.5 million for \$11.5 million dollar reduction for the year. We paid dividends of \$1.2 million in the quarter or \$0.04 a share and \$3.6 million or \$0.12 a share for the year.

Our bank debt at September 30 was \$238 million and our net debt with our cash was \$225 million at the end of September. We still target our bank debt to be \$230 million to \$235 million at the end of the year and our debt to EBITDA ratio was 3.02 times for the nine months.

Now I'll turn it over to Brent Bilisland, our CEO for his comments and insight.

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### Brent Bilisland - Hallador Energy Company - President & CEO

Thank you, Larry.

In the third quarter, we're pleased that Hallador continue to generate positive cash flow allowing us to further reduce our bank debt, pay dividends and fund our capital expenditures. We know that our financial performance has been a direct result of the special men and women that choose to work for Hallador and its subsidiaries, primarily Sunrise Coal. We are very thankful for their hard work and commitment to excellence. Due to their efforts, we have been able to successfully manage through a challenging market. That said, we are encouraged by size that show the market is improving.

From the demand side, this summer brought strong burns due to hot weather which has helped our customers inventories get back in line. Natural gas prices have improved substantially and the export market has shown dramatic improvement to the point that volume from Illinois basin is now moving to export.

On the supply side, there have been a number of mines closed or announced they soon will be closing. We expect to see similar announcements over the next year by the continued lack of investment that we're seeing by our competitors. As we review our third quarter results, it is of no surprise that our lower sales prices led to lower margins. As we compare the previous six quarters to our third quarter, the average sales price was down \$1.70 a ton at our margin accordingly was down \$1.72 over the same period.

In the fourth quarter, we expect to see higher volumes. As we discussed in our second quarter call, we thought there would be significant sales in the quarter and there were, so we now expect our fourth quarter to be our largest from a sales volume perspective. We expect our fourth quarter sales volume to increase 17% over the third quarter and we expect our average sales price to be \$42.80.

For full year 2016, our sales forecast will be \$6.3 million. As we look to 2017, we're forecasting 6.0 million to 6.5 million tons. Currently, we have sold 4.9 million tons at an average price of \$43.67. There are numerous RFPs outstanding, so we feel that here over the fourth quarter, we will continue to sell coal in large part due to all the reasons we talked about before in the improving market, as far as higher gas prices, export market and stronger burns.

We continue to stress the importance of our large forward contract position, consisting of a minimum of 22.2 million tons through the year 2024. We believe this large book of business will continue to bring a lot of value to Hallador shareholders.

Production cost for Oaktown during the third quarter were \$29.57 a ton. For the remainder of 2016, we continue to forecast \$28 to \$30 a ton. Going forward, we expect our SG&A expense to be \$11 million annually and cost associated with Prosperity and Carlisle to be \$10 million annually. With Carlisle currently in the hot idle status, Hallador is well-positioned to respond to the market quickly when it approves with over 3 million tons of additional capacity.



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Bank debt and cash flow, we generated \$12.9 million from free cash flow in the third quarter. This cash was used to pay \$11.6 million towards our bank debt. [We have \$0.04 a share] dividend and fund our capital expenditures. Our liquidity position at the end of the third quarter was \$78 million. And on our safety front, we're proud to announce that our Mine Rescue Team competed and won the 2016 Nationwide Mine Rescue Skills Championship held in Madisonville, Kentucky. 13 teams from five different states were eligible to compete, only after placing in a preliminary competition. The nationwide skills championship is divided into seven skills competition and a written test. We thank our members of Sunrise Mine Rescue team for their focus and dedication towards safety.

With that being said, I'm now going to open up the phone lines for questions.

### QUESTIONS AND ANSWERS

#### Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) Lucas Pipes, FBR & Co.

#### Lucas Pipes - FBR & Co. - Analyst

I wanted to -- first, good job in the quarter, but I wanted to follow-up a little bit in terms of your contract position '17 through '19. It looked like there were few moving pieces there. I think you've referenced your contract position briefly in the prepared remarks if I understood you correctly. But I was wondering if you could give us a little more flavor in terms of what you're looking to lock up here over the next few months or so into year-end, how your utility customers are looking at this market, how you're looking at it and also what the changes were versus the prior quarter? Thank you.

#### Brent Bilslund - Hallador Energy Company - President & CEO

Well, I think changes to the prior quarter -- we've had -- we sold a little more coal, and we had I think at least one customer requests that we move tonnage forward, instead of a deferral, the opposite, move tonnage from 2017 into 2016.

As far as what we're expecting, I think we say that we forecasts and we're going to sell 6-6.5 million tons next year. We currently have 4.9 million sold, there is quite a number of RFPs that are currently outstanding and we are yet to hear the results of those.

#### Lucas Pipes - FBR & Co. - Analyst

Got it. And in terms of your customers, so you mentioned a number of RFPs out there, are they getting a little worried with gas coming up over the summer with burn being stronger; how would you describe their sentiment towards the market at this time?

#### Brent Bilslund - Hallador Energy Company - President & CEO

Well, I think there -- I think we're all a little surprised of how strong export markets have dramatically increased and how quickly they increase, I think that caught all of us a bit by surprise. And I think that will force them to be a little more aggressive in their buying, otherwise they risk kind of a unique scenario is -- tons going to export at the same time that you seem -- I think a substantial amount of production close permanently. So -- it's tough to be a utility buyer right now because gas prices move a lot, they move quickly, but now you throw in the export component; I think that's got them particularly concerned.

#### Lucas Pipes - FBR & Co. - Analyst



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That's helpful. And then maybe if I could follow-up a little bit on the export side; so -- you have experience with moving tons over long distance, I know you have some customers down in the Southeastern area of Florida among others. Is there a possibility to move tons for you into the export market or is this -- or do you see yourself more as an indirect beneficiary where some of the peers that have already reported -- they mentioned that they are going to be exporting a couple of million tons here. And you're -- sort of say the indirect beneficiary as those volumes are pulled out, you can fill a void -- how do you see yourself and that affected by this export -- strong export market?

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

I think it's definitely a possibility that we may move some tons to export. That being said, our primary market is the domestic market. So it'll be interesting to see -- I think obviously all ships rise in a rising tide, but we see potentially some coal going to export, but the majority of our business being domestic.

**Lucas Pipes** - FBR & Co. - Analyst

Got it. If you had to take an estimate in terms of how many tons you could move overseas; set in the millions -- little less than that, where would you ballpark the export potential?

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

Well, I think the main issue today is the export market pricing is aggravated, meaning December and first quarter is pretty strong numbers, and then it's down from there. So the question will be, is this blip going to be limited to the first quarter or is it going to -- or the latter months going to catch up to the current market? So that's a very temperate answer I know, but I would say hundreds of thousands not millions.

**Lucas Pipes** - FBR & Co. - Analyst

Very helpful, thank you. And then last one for me and then I'll pass it on. And given the volatility and you've referenced this just now -- given the volatility in pricing at that (inaudible), what is the price? Where do you think on an API-2 your breakeven and moving export tones kind of on a net back basis; so what's the API-2 breakeven that you think you require?

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

That's not a number that we're going to disclose, but I will tell you that you're seeing tons move and there is certainly a lot of discussion around that. So the current market is very close.

**Lucas Pipes** - FBR & Co. - Analyst

Great, I appreciate it. And good luck with everything.

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

All right, thank you, Lucas.



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### Operator

(Operator Instructions) Arthur Calavritinos, ANC Capital.

### Arthur Calavritinos - ANC Capital - Analyst

Thank you. Just a follow-up on the last question, on the export market; I know you guys have been great at calling the domestic market for the past two years since we've owned the stock. What are you guys seeing there, what's driving it? And any strength of volumes just industry-wise surprised you guys, how you think about it? And that's it, thanks you.

### Brent Bilsland - Hallador Energy Company - President & CEO

I think primarily the export jump has been caused by new work rules in China, limiting the amount of production there that they are allowed to operate their mines in China. So that's created a void in the international market and the US is now back-filling Europe, and it was pretty dramatic and move with the API-2 in the last couple of months.

I think the question for everyone is going to be is how long will that be sustained. Obviously, none of us know, but -- so that's what's driving the market, those are the type of surprises that -- when you have a reducing supply of coal and then you have a surprise demand, we can see a lot of movement in a short period of time. So we hope that continues to -- that trend continues.

As far as volumes, I know I've heard of some other companies in Illinois basin moving up to 3 million tons. I'm sure there are others, especially out of Illinois. And that's good for the market, when you look at the Illinois basin producing 110 million tons to 130 million tons, if we can see 10 million tons move to export that we weren't expecting, that's pretty significant. So it's a great trend, we hope it continues.

### Arthur Calavritinos - ANC Capital - Analyst

And let me ask you some follow-on, I just thought about it. When I was talking to somebody about the nat gas market in the States, we all know what the winter did and also last summer going into -- we were out of Boston, so we know what the weather did.

Europe, you know -- if I look at the weather in Frankfurt and Northwestern Europe, it was warm and it hit the market pretty good, if we have a normalization, you guys and other companies have talked normalization of winter. If we had that in Europe because it was pretty warm there, again impacts -- just talk a little bit about that impact also, if you could? And that's it, thank you.

### Brent Bilsland - Hallador Energy Company - President & CEO

Well, it's certainly cold weather leads to more BTUs being consumed. What the impact of a few degrees one way or another in Europe, that's not my area of expertise, but here in the States, coal is still the money in Indiana and we've got -- October has been a very mild month, November has started off the same way, but if we see some winter creep up, there is going to be some very strong coal demand in the State of Indiana, which is our primary spot for coal and Florida as well. So we're hopeful for cold winter.

### Arthur Calavritinos - ANC Capital - Analyst

I'll take a normal one, you know -- just a normal one.

### Brent Bilsland - Hallador Energy Company - President & CEO

I'd take a normal one too I guess.



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(Operator Instructions) Lucas Pipes, FBR & Co.

**Lucas Pipes** - FBR & Co. - Analyst

Thanks for taking my follow-up question. So I remember last quarter, I had a question on the potential for Carlisle coming back, I wanted to ask - how do you look at this today? Where could it fit in? Is that maybe something given idling costs that if you could push it into the export market, it would maybe be a little faster to push through those opportunities? Thank you.

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

Yes, it's something we definitely consider. We want to see our sales position strengthen a little more, we'd like to see pricing strengthen a little more before we bring additional capacity back online, and so far I think the basin has been pretty disciplined about -- we really haven't seen an uptick in supply even though we have definitely seen an uptick in pricing versus what we were seeing five, six months ago.

So the trend is certainly in the right direction Lucas, and it's certainly something that is a possibility. Again, right now the export market is kind of heavily weighted towards the first quarter and we wouldn't bring a mine back online just for one quarter. So this market can get a little legs under it, we'll see.

**Lucas Pipes** - FBR & Co. - Analyst

Got it.

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

And certainly that would be very beneficial to our financial results.

**Lucas Pipes** - FBR & Co. - Analyst

Yes. And in terms of -- just logistically, how would you move tons into the export market? Would it be on barges, on the rail, would it be New Orleans on the port side or in East Coast port; if you could give us sense for kind of which direction the coal would flow? I would appreciate those details.

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

Yes, we would go well direct to the East Coast.

**Lucas Pipes** - FBR & Co. - Analyst

Got it. Okay, that's helpful. So it would be either -- probably be it like Baltimore, would that be the best port?

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

I think so, yes.



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(Operator Instructions) At this time, I'm not showing any additional questions in the queue. I would like to hand the conference back over to Brent Bilisland for any closing remarks.

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

Well, I want to thank everyone for taking the time to listen to our call today and we look forward to the strengthening market, and we think it would be very beneficial in results and we appreciate all of your time and efforts, thank you.

**Operator**

Thank you, sir. Ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.

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