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Becky Palumbo Hallador Energy Company - Director of IR

Larry Martin Hallador Energy Company - CFO, Sunrise Coal LLC

Brent Bilsland Hallador Energy Company - President & CEO

CONFERENCE CALL PARTICIPANTS

Operator

Lucas Pipes FBR & Co. - Analyst

David Pointer VI Capital Management, LLC - Analyst

Arthur Calavritinos ANC Capital - Analyst

PRESENTATION

Operator

Good afternoon and welcome to the Hallador Energy Company's second quarter 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 also note that this event is being recorded.

I would now like to turn the conference over to Becky Palumbo. Please go ahead.

Becky Palumbo - Hallador Energy Company - Director of IR

Thank you, Andrea. Good afternoon. Welcome to our Q2 2016 earnings call. Friday afternoon August 5, we filed our Form 10-Q with the SEC. It is available during this call on our website under the SEC filings tab. This call is being webcast and a replay will be available on our website, along with a transcript later this week. On today's call will be Brent Bilsland, our President and Larry Martin, our CFO.

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.

The format for today will be a discussion from management followed by a Q&A period.

Larry will now discuss our second quarter highlights.

Larry Martin - Hallador Energy Company - CFO, Sunrise Coal LLC

Good afternoon, everyone. I may go over some highlights of our operating results and then I'll turn the call over to Brent for comments and insights.

Hallador achieved $5.9 million of net income for the quarter or $0.19 a share. This resulted in $12 million in net income for the year or $0.40 of share.

Our free cash flow, which we define as net income plus deferred income taxes, plus depreciation, depletion and amortization, plus stock compensation expense, less maintenance CapEx -- our free cash flow was $15.9 million for the quarter, $29.8 million for the year.

Our adjusted EBITDA defined as EBITDA plus stock compensation amortization was $20.7 million for the quarter, $44.1 million for the year.

We incurred no debt in the second quarter and incurred $15 million for the year, which we talked about in the first quarter for the Freelandville purchase.

We reduced our -- or we repaid down debt of $6.6 million for the quarter and have paid down $14.9 million for the year. We paid dividends in the second quarter of $0.04 a share, $1.2 million and for the year, we paid $0.08 a share, $2.4 million.

Our bank debt at June 30 was $250 million and that with our cash equated to a net debt of $233 million at the end of June.

Our debt target for the year is $230 million to $235 million for the year or at 12/31 and our debt to EBITDA ratio equated to 2.93 for the past 12 months.

I will now turn the call over to Brent, our CEO, to give his comments and insight for the quarter. Brent?

Brent Bilsland - Hallador Energy Company - President & CEO

Thank you, Larry. We continue to be pleased with the financial results of Hallador as we continued to generate positive cash flow, allowing for us to further reduce our bank debt, pay dividends and fund our capital expenditures. We know that the results are the direct results of our special men and women who choose to work for Hallador and its subsidiaries, primarily Sunrise Coal.

We are especially pleased with our results, when you consider they are occurring at a time when much of the industry is under extreme duress. As we sit here today approximately 40% of the US coal industry is in bankruptcy and we estimated another 15% is near bankruptcy.

From a marketing perspective, the past 12 months have been particularly challenging. As you may recall the summer of 2015 was mild and was followed by the warmest winter recorded in 130 years thus reducing demand for power for heating and cooling purposes. During the same time period, the US dollar increased 20% versus most other currencies. This strengthening in the US dollar virtually eliminated the coal export market.

At the same time, natural gas production was an all-time high, thus natural gas at a price down to a point, low enough to where it could displace enough coal to absorb the glut of excess gas production. Natural gas prices dropped to the $1.60 range and coal inventories increased dramatically throughout the country. We at Hallador call this conversion of event the perfect storm.

Fortunately for Hallador in the coal industry the summer has been hot causing natural gas prices to increase and coal inventories to drop. In the second quarter, we shipped 1,464,000 tons at an average price of $45.27. This was a little ahead of schedule. And basically due to our customers' increased demand for power, they asked us to ship ahead of our contracted responsibility.

We think it's likely that we'll see additional sales this year. However, if additional sales fail to materialize our sales this year -- our volumes will be lower in the second half of 2016.

For the full year -- first half of the year we shipped 3,090,000 tons at an average price of $45.93. In the second half of this year we've contracted to ship just a little under 2.9 million tons at an average price of $43.57.

For full year 2016 we are forecasting sales to be in the 6 million to 6.2 million ton range. For 2017, our sales commitment is currently at a minimum of 4.6 million tons at an average price of $44.47.

As mentioned previously, coal inventory levels are normalizing. And the forward curve for natural gas futures is back above $3. As a result, we think 2017 sales will be similar to 2016. If market opportunities do improve Carlisle is in hot idle status, allowing us to respond to the market quickly with over 3 million tons of additional capacity. We continue to stress the importance of our large forward contracted position consisting of a minimum of 23.3 million tons through 2024. We believe this large book of future business brings a lot of value to the Hallador shareholder.

We are pleased with Oaktown's cash costs for the second quarter of $28.29 a ton, well within our forecast of $28 to $30 a ton. For the remainder of 2016, we continue to forecast costs will be in the range of $28 to $30 a ton. Going forward, we expect our SG&A to be $12 million annually and costs associated with Prosperity and Carlisle to be $9 million annually.

We generated $15.9 million of free cash flow in the second quarter. This cash flow was used to pay $6.6 million towards our bank debt, pay a $0.04 a share dividend and fund our capital expenditures.

Our liquidity position at the end of the second quarter was $83 million.

And with that said, I'm going to open up the lines for questions and answers.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Lucas Pipes, FBR & Co.

Lucas Pipes - FBR & Co. - Analyst

Good job on the quarter. Appreciate all the details. My first question is on the market dynamics. It looks like inventories are going into the right direction, burn is picking up. What's the discussion with your customer regarding 2017 volumes? How is that market looking right now, would appreciate your thoughts? Thank you.

Brent Bilsland - Hallador Energy Company - President & CEO

I think the market has been long for a long period of time. So they're very cautious to come back and start buying. That being said, I think there is a lot of utilities that need to purchase coal for 2017, perhaps even 2016 as well. So the attitude has changed dramatically. March-April time frame of 2016, I think a lot of people were questioning how much coal they were ever going to buy again. And as a result of this hot summer, I think the utilities have been reminded that they can burn a lot of coal in a hurry. So we look for buying to occur later this year.

Lucas Pipes - FBR & Co. - Analyst

Interesting. So do you have a target as to how much of your 2017 volumes you would like to have under fixed pricing by the end of the year? Is there something we should be looking forward to on that metric?

Brent Bilsland - Hallador Energy Company - President & CEO

Hard to say how much will be nailed down by the end of the year because what's not clear is how the utilities are going to play it. Are they going to try to purchase the shorter term in nature as possible or are they going to look to go out and buy two to three years of business. And we will just have to see how those negotiations go.

Basically we're going to try to sell all the coal we can and I think the point is we have a lot of capacity to be able to -- they can respond in quick fashion if the market needs us to. But in the meantime, we will currently stay in -- we are very comfortable at the production capacities we are at today.

Lucas Pipes - FBR & Co. - Analyst

Got it. That was actually -- my second question was regarding your capacity. How quickly you could, A, dial it back up and what sort of costs would be associated with that? And then I think in the 10-Q you also laid out some assumptions for the valuation of Carlisle. If you could kind of share with us how you were thinking about those? I would appreciate it as well. Thank you.

Brent Bilsland - Hallador Energy Company - President & CEO

Well, the first part of your question, I think we would have to hire more people. Unfortunately, we had to let people go last year to kind of size down to right size our production to meet the current demand. So as the demand returns we will have to go out and hire people, but there is certainly -- we certainly have a very talented group to start with.

So part of that $9 million that we're spending at Prosperity and Carlisle on an annualized basis is so that we have a group of people at Carlisle now and we have kept a lot of management talent there so that we can respond very quickly.

As far as additional cost, I can't really think of any. I'm not sure I understood the second part of your question.

Lucas Pipes - FBR & Co. - Analyst

So, thank you for those details. That was helpful. And that the second part of the question was regarding the valuation of Carlisle. I don't think you took an impairment charge at Carlisle and I think you laid out those assumptions in the 10-Q. And I believe that it contemplates a restart, if I recall correctly, it was 2018, but I'm not 100% sure on that. So it was kind of -- I was hoping for a little bit more color regarding the plants to start up that mine again in the future. So if you could provide some thoughts around those assumptions, I would appreciate it?

Larry Martin - Hallador Energy Company - CFO, Sunrise Coal LLC

Well, Lucas, our assumptions that we use to evaluate whether we had an impairment or not in the value Carlisle, we assume that we would start -- that we would need to start up Carlisle in 2018, slowly through 2018, 2019 and to be back full board by 2020. So we believe we're being very conservative there because I think now with the hot summer and with what's going on, we think it will come back even faster than we used in our impairment evaluation.

So we just believe we're very conservative in our evaluation there and we think actually now to come back even quicker than what we used in our assumptions.

Lucas Pipes - FBR & Co. - Analyst

Perfect. That's helpful. And if I could maybe squeeze in one last question, despite this most recent improvement in the market there is unquestionably still a lot of distress out there in the coal space. Are you looking at -- how are you looking at that at that, that broader picture, are there opportunities for consolidation? Where would Hallador fit into that?

Brent Bilsland - Hallador Energy Company - President & CEO

Well, yes, I mean I think stress to any industry leads to consolidation. And as we talked about in the call, we got 40% of production in bankruptcy, we got another 15% that's potentially very close. So it does lead to some unique opportunities. If you look at our actions in the first quarter of 2016, we purchased contracts and we field the majority of the reserves from the Freelandville mine from Blackhawk. So, that was an opportunity to add some (inaudible) to our sales next year and add reserve, but also to, we think, really limit the abilities of a competitor.

So, if we see opportunities like that in the future, especially in Indiana, we would definitely be interested. But there is got to be the right opportunities to drive valuation. And we just don't want to do anything that's going to put any more undo leverage on to our balance sheet. We feel we're in a really comfortable place. We've loosened all of our loan covenants up in the first quarter of this year, maybe beginning of the second quarter.

So, we just feel that we can continue to do what we do, generate cash, pay down debt, pay our dividends and continue to fund our maintenance CapEx. We think that a lot of the industry is under funding its maintenance CapEx, therefore production is eating itself. And we feel that we've continued to invest in our assets and keep them in [tip-top] shape, which is keeping our cost structure low. And it's going to ensure that we're successful long into the future, especially coupled with our -- we think our long-term contractual position as we have a better base than we feel most of our competitors do when you look out to the future.

Lucas Pipes - FBR & Co. - Analyst

Yes. That's very helpful. I appreciate your perspectives and good luck this year. Thank you.

Brent Bilsland - Hallador Energy Company - President & CEO Thank you,

Lucas.

Operator

(Operator Instructions) [Arthur Calavritinos, ANC Capital].

Arthur Calavritinos - ANC Capital - Analyst

Thanks for taking my question. Just a couple of questions here. You guys in the past year and a half have been really good at calling the natural gas market with your insights and then obviously effecting for prices of coal. But I have been reading a lot about nuclear plants shutting down or more movements outside Boston here and we're doing the same thing to one of our nukes that we did one at Vermont and that's a positive thing from nat gas. I wonder if you could touch on that because that looks like sort of an untold story.

And then the second housekeeping item, is the amortization in the back half of the year basically going to be the same you have at the beginning of the year on the lines to credit? That's it. Thank you.

Brent Bilsland - Hallador Energy Company - President & CEO

I'll take the first part of that. On the nuclear front the nuclear operators, especially in the State of Illinois have been making a lot of noise that as we bring more and more renewables into the system, when the wind blows and the sun is bright you've got a lot of renewable generation coming on line and it is pushing the wholesale price of power lower. A nuclear facility can't cycle. So you got the nuclear operators saying, hey, there's times where actually the grid is going negative for power pricing at times and nukes are saying we are producing power and we actually have to pay to put them on the grid. So it really can't -- the fundamentals just in a newer world where we put more and more renewables on the system, everything else has to cycle quicker and nuclear generation doesn't do that very well at all.

So in some markets such as PJM, you're seeing maybe some capacity factor payments being made to the nukes to keep them on line, but MISO district doesn't really have that same payment structure. So it's going to be very difficult for nukes. There's a lot of them threatening to shut down. What will that be replaced with, well rest of the grid will have to make up. So it's probably bad for nuclear, good for coal and natural gas.

As far as the amortization, I'll let Larry handle that.

Larry Martin - Hallador Energy Company - CFO, Sunrise Coal LLC

Yes, the banking amortization on the notes, that was the question, I believe, that will be fairly the same as the first half through the second half. As most of the people that are familiar with our calls here know we are very conservative. So any excess cash that we generate in excess of our required amortization will be used to pay down debt.

Arthur Calavritinos - ANC Capital - Analyst

Okay, thank you. And just a follow-up on a previous question on consolidation. We've got some other companies coming out of bankruptcy with not a lot of debt. They will have a stock currency to do stuff. When you look at the industry, I'm not talking about you guys, but in general, just if you could look out and see, I mean does it make sense here? And I know you alluded to it on the previous question for consolidation, because you're not just competing with coal within coal, you're competing with nat gas, nukes and the renewables. Thank you.

Brent Bilsland - Hallador Energy Company - President & CEO So, I am

not sure I understood your question.

Arthur Calavritinos - ANC Capital - Analyst

Well, these guys are going to be coming out of bankruptcy like Peabody and follow the other guys, Alpha Natural, the big guys coming out, they are not on a restructuring and have a lot of debt that will be eliminated. So they'll have some bit of cash and an equity value, some of the transfer of the value from the debt into the equity. And I'm just wondering as you look at the industry, could you see some consolidation just happening?

Brent Bilsland - Hallador Energy Company - President & CEO

I think you are seeing consolidation happen. I mean, if you look at the state of Indiana just a few years ago when we bought out Vectren the coal assets, there has been a couple of other smaller players that had sold assets off, maybe hasn't made as bigger headlines as some of the bankruptcies have. We think that, A, I think that as the larger companies come out of bankruptcy, they still will have debt. That will be more of a manageable amount of debt, at least they say.

I think the thing is if you pay particular attention and what we've been noticing is that maintenance CapEx spending for the past three or four years has been woefully short. Most of these companies levered up to buy metallurgical steel assets then that the met market fell apart. So they had to rely upon their steam assets to service all those new debt.

And then when we had the mildest winter in 130 years of record keeping, it caused this glut of BTUs and it's not just stress on the coal industry. You've had, I think, 42 oil and gas companies to file for bankruptcy last year as well. I mean, natural gas pricing down below $2 or even $2.50 for that matter is unsustainable which is why we're seeing in the next three years of forward curves in natural gas to be above $3.

So we think, to circle back to your question, we think that when these coal companies come out of bankruptcy they're going to have a lot of assets that they have to re-capitalize and they're only going to have so much capital available to them to do that. So they are going to have to focus their dollars on what they think their best performers are and either try to sell or close the other assets because they just don't think there's enough capital to go around, because these assets are basically been eating themselves for such a long period of time. We don't spend our money on maintenance CapEx just for joy of spending money.

Arthur Calavritinos - ANC Capital - Analyst

Okay. All right, beautiful. All right excellent. Thank you.

Operator

(Operator Instructions) David Pointer, VI Capital.

David Pointer - VI Capital Management, LLC - Analyst

Thanks for taking the questions. So just a couple of quick ones. In the table in the Q where you show the tonnage and operating costs and cost per ton, it seems like you've been kind of guiding for a while at $28 to $30 but it always comes in above $30. Is it the same number or is there something else in there? I mean is that are you kind of aggressive on your cost guidance because it seems like it's always a little higher. And I know that it was variable with kind of wash plant recovery and the different -- the quality of the vein that you're in on a quarter-to-quarter basis, but it just seems like the $28 is long gone. (multiple speakers)

Brent Bilsland - Hallador Energy Company - President & CEO

No, I think what the misconception is, so at our Oaktown facility, which is operating at roughly 6 million ton pace, there we are producing tons at $28. But in that table, we are also including the $9 million that we're spending for the holding cost of Carlisle and Oaktown. So when you add that all together that takes our average cost of production up to $31 range. We separated out that way so that we can show the market what is cost against the hot-idle and what we think those costs go away once we bring the Carlisle production back on line, which we're forecasting sometime in 2018.

David Pointer - VI Capital Management, LLC - Analyst

Okay. And I'm glad you do. Thanks for separating. That's helpful. The other question is ton, maybe more strategic level question, and you've made some comments about the Freelandville assets and as a shareholder for a while, I kind of wonder it looks like as a good purchase, a lot of distressed assets. I'm sure there is some attractive things come across your desk to look at. But because of the valuation of Hallador, it's so cheap, for the $18 million, you could have bought 13% of your whole company. You could have bought back pretty big chunk of stock. And how do you think about that?

Is there anything with your account that would restrict you from doing that? I mean that's a big natural seller that you probably could buy some stocks back if you wanted to buy stock back, maybe your bankers wouldn't be comfortable with it. But they loaned you money, debt basically been flat for six months because of that purchase. I mean, how do you kind of think about that because it's such a low valuation of your own shares, how do you think about that opportunity?

Brent Bilsland - Hallador Energy Company - President & CEO

Well, I think when we looked at that first of all we really wanted to -- a big part of the value was the contracts. So we wanted the sales for 2017. That was done at a time when the market was a lot less optimistic than it is today.

Secondly, I think that when there is an opportunity to buy competitor assets those windows of opportunity aren't opened very long. I think from our share standpoint as we continue to generate cash to pay down debt, we will re-evaluate that from time to time and if it makes more sense to buy in stock we will do so. But down the road, we will continue to have -- we kind of view it as the opportunity to buy in stock it's probably there in the future and if it isn't that means we have a stock price that's higher in value than what we think, well, it's not the best opportunity for our use of capital. So, I guess when we looked at it, we thought that purchasing the Freelandville assets was our best of use of capital. So that's the decision we made.

Larry Martin - Hallador Energy Company - CFO, Sunrise Coal LLC

Well, I want to add, it's a lot easier in a distressed market to borrow money to buy an asset that's going to pay that loan back versus borrowing $18 million to buy our stock.

Brent Bilsland - Hallador Energy Company - President & CEO Which

doesn't create any additional EBITDA.

Larry Martin - Hallador Energy Company - CFO, Sunrise Coal LLC

No, additional cash flow or anything in the market that we were in back when we made that purchase.

David Pointer - VI Capital Management, LLC - Analyst

Point taken. However, in the last six months the debt has been flat, really, it has. And you paid back $15 million and it's still been flat because you borrowed $15 million, right. And so the year previously, after the transaction of Vectren, the focus was pretty much on shrinking debt. And in the last six months it hasn't dropped. And you could have taken that $15 million and bought back stock. In other words, it just strikes me --

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Brent Bilsland - Hallador Energy Company - President & CEO

Yes, but David our point is the decision -- what we brought will create future EBITDA, which you're proposing will not and would actually put us in a more leverage scenario.

David Pointer - VI Capital Management, LLC - Analyst

I'm not disagreeing, I just wanted to raise the point that you got a really cheap stock, and that's a great way to create value?

Brent Bilsland - Hallador Energy Company - President & CEO

We're glad you think our stock is cheap, please take advantage of that.

David Pointer - VI Capital Management, LLC - Analyst Okay.

Fair enough. Thanks for the question.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Brent Bilsland, for any closing remarks.

Brent Bilsland - Hallador Energy Company - President & CEO

Well, I just want to thank everyone for taking the time to call in today and taking interest in Hallador Energy and we look forward to hearing from you all in future earnings calls. Thank you very much.

Operator

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