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Earnings Call

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Call Participants

EXECUTIVES

Brent K. Bilsland
President, CEO & Chairman

Marjorie A. Hargrave
Chief Financial Officer

Sean Mansouri

ANALYSTS

Lucas Nathaniel Pipes
B. Riley Securities, Inc., Research Division

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Presentation

Operator

Good afternoon. Thank you for attending today's Hallador Energy's Second Quarter 2024 Conference Call. My name is Cole, and I'll be the moderator for today's call. [Operator Instructions]

I'd now like to pass the call over to Sean Mansouri, the company's Investor Relations adviser with Elevate IR.

Sean Mansouri

Thank you, and good afternoon, everyone. We appreciate you joining us to discuss our second quarter 2024 results. With me today are President and CEO, Brent Bilsland, and CFO, Marjorie Hargrave. This afternoon, we released our second quarter 2024 financial and operating results in a press release that is now on the Hallador Investor Relations website. Today, we will discuss those results as well as our perspective on current market conditions and our outlook for 2024. Following prepared remarks, we will open the call to answer your questions. Before beginning, a reminder that some of our remarks today may include forward-looking statements, subject to a variety of risks, uncertainties and assumptions contained in our filings from time to time with the SEC and are also reflected in today's press release.

While these forward-looking statements are based on information currently available to us, if one or more of these risks or uncertainties materialize or if our underlying assumptions prove incorrect, actual results may vary materially from those we projected or expected. In providing these remarks, Hallador has no obligation to publicly update or revise any forward-looking statements. whether as a result of new information, future events or otherwise, unless required by law to do so. We plan on filing our Form 10-Q later this week.

And with the preliminaries out of the way, I'll turn the call over to President and CEO, Brent Bilsland.

Brent K. Bilsland
President, CEO & Chairman

Thanks, Sean. At Hallador, we've been undergoing a strategic and deliberate transformation process to capture increased value from our products and services as the company advances up the value chain. To accomplish this, we have focused on expanding our offerings from fuel production to wholesale electricity sales to ultimately powering the industrial end user. The acquisition of our Merom Power plant, less than 2 years ago, was the first step in this journey, enabling us the ability to transform our fuel into higher-value wholesale electricity. We took another step forward earlier this year when we signed a memorandum of understanding with Hoosier Energy and WIN REMC, creating a pathway to further increase value and drive margin expansion by enabling sales of wholesale electricity to industrial users of power.

We have recently carried out a data center targeted request for proposal that has received a strong response. Our active negotiations on that RFP further strengthen our conviction that power is in critical demand and that we possess a crucial component to the success of these data centers. While we are encouraged by our progress with our counterparties, we caution that these negotiations are ongoing and take time given the potential magnitude for both our partners and our company. Nearly all of these proposed transactions would involve sales of large amounts of our energy and capacity for well over a decade. The state of Indiana, where our power plant is located, continues to solidify its position as the developing hub for high-tech and high-growth sectors.

The Indiana Economic Development Corporation reports the plans for nearly $15 billion of new investments in Indiana's technology infrastructure have been announced by Fortune 500 businesses thus far in 2024, underscoring the growth potential in our marketplace. Businesses need power to enable them to build in Indiana, and Hallador is one of the few companies that has. We believe we are entering a unique time of electricity scarcity. We have heard multiple reports from across the country where utilities have told industrial customers they cannot timely provide them with power needed to support their

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growth. We have seen numerous companies reference the lack of available power as restricting their company plans.

Last week, the results of the PJM capacity auction, a neighboring market to the MISO system where we operate had certain zones where capacity prices traded up to the legal limit as much as 9x more than the previous year. This result supports our belief that the value of dispatchable generation like our Merom plant continues to increase. Energy scarcity is leading to higher long-term power prices as evidenced by significantly higher energy prices starting in 2026 as contracted by Hallador and forecasted by the forward energy curve. I would also like to point to a recent Wall Street Journal article, reporting that heavy industrial users of power, such as aluminum smelters are struggling to compete for electricity with higher value users of energy, such as data centers. According to the article, in the year 2000, there were 23 aluminum smelters located in the United States. Today, there are only 4.

During the quarter, we added $45 million in forward energy sales, bringing our forward capacity and energy sales book to $664 million as of June 30. When combined with our forward fuel sales, our total forward sales book at June 30 totaled approximately $1.4 billion. Unfortunately, the recent environment for spot electricity sales has been challenging. This past winter, record high U.S. natural gas production ran into the ninth warmest winter on record according to NOAA, the lack of winter heating demand contributed to gas inventory levels, climbing as most of 38% above the 5-year average. As gas prices address downward, wholesale electricity prices also declined. In the first 6 months of 2024, approximately 90% of the off-peak energy hours at the Merom Hub and approximately 60% of the total energy hours at the Merom Hub, price below our production cost at our Merom facility.

Our goal is for Hallador Power to generate approximately 1.5 million megawatt hours on a quarterly basis, which equates to approximately 6 million megawatt hours annually. During the first half of 2024, Hallador Power generated approximately 1.6 million megawatt hours during the first half of the year. We experienced sales prices of nearly $261 per megawatt hour for limited times balanced against most days, pricing below our variable cost to produce. These fluctuations led to an inconsistent dispatch schedule. We also performed 70 days of scheduled outages on half the plant during the first half of the year. We believe the environment will be better in the last half of this year to see higher dispatch rates as we have no scheduled outage for the plan for the balance of this year. Additionally, our plant already ran 437,000 megawatt hours for the month of July.

Gas inventory levels have also improved from 38% above the 5-year average in March to 16% above the 5-year average at the end of July. For the first half of 2024, lower energy prices negatively affect both Hallador Power Company's generation model and the dispatch rates of Sunrise Coal's utility customers. In response to dispatching less, those customers slowed coal shipments from Sunrise during the first half of this year. To match Sunrise's production levels and cost structure to that of market demand, we restructured Sunrise's operations in the first quarter of 2024. As we have previously noted, the restructuring included a reduction in force of approximately 110 people in February. We have since allowed attrition to further reduce our workforce by approximately 130 additional people, a total workforce reduction of more than 25% as of June 30.

We also restructured our operations to focus on our more profitable units into idle units with higher production costs. Transitioning our Oaktown mining facilities from 7 units of production to 4 units of production was a deliberate process, which took considerable time and effort and was completed in mid-July. We are encouraged by the early results of Sunrise's restructuring and has seen improvement in mining costs since we made the decision to adjust our operations. Our clean tons per foot of advancement, a key efficiency metric we utilize improved from January to June by 27%. And our June cash cost at Oaktown were approximately $44 a ton while our cash costs for the quarter were approximately $50 million. We expect to continue driving improvements in cash cost in the second half of the year as we have already implemented further operational improvements in the month of July.

It's worth noting that you will not find these cash cost numbers in our upcoming 10-Q filing as we have revised the presentation of our financials to conform with GAAP. Overall, we're enthusiastic about how it was prospect for significant growth and value creation. The improving energy market landscape provides a solid foundation to return to growth as we exit 2024, and we believe the surge in demand to power data

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centers and other industrial users provides a real opportunity to transform our financial profile over the long run.

I will now hand the call over to Marjorie Hargrave before opening Q&A and returning for closing remarks.

Marjorie A. Hargrave
Chief Financial Officer

Thank you very much, Brent, and good afternoon, everyone. Turning to our second quarter financials. Electric sales for the quarter were $56.8 million compared to $71 million in the prior year period. The decline was primarily due to an abundant natural gas supply, leading to low energy prices. This, coupled with the mild winter and scheduled maintenance resulted in our dispatch rates being decreased. Coal sales were $32.8 million for the quarter compared to $88.6 million in the prior year period. This decline was driven by our decision to reduce our coal production as previously discussed in our restructuring of our Sunrise Coal division. Additionally, a slowdown in customer deliveries coincided with the decrease in coal plant output throughout the quarter. These 2 segments drove revenue of $90.9 million for the quarter compared to $161.2 million in the prior year period.

Net loss for the quarter was $10.2 million compared to positive net income of $16.9 million in the prior year period. This was largely driven by a loss in coal operations of $13.33 per ton due to a reduction in contract average sales price and reduced demand given the oversupply of lower-priced natural gas and reduced dispatch rates at our customers' coal-fired power plants. We improved operating cash flow to $23.5 million for the quarter compared to $18.1 million in the prior year period. Adjusted EBITDA, a non-GAAP measure, which is reconciled in our earnings press release issued earlier today, was negative $5.6 million for Q2 compared to $35.3 million in the prior year period. We invested $13.1 million in capital expenditures during the second quarter, bringing total year-to-date CapEx to $28 million. This puts us well on target for our planned capital outlay of $43 million for calendar year 2024.

In response to the current environment, we focused on strengthening our balance sheet. During the second quarter, we decreased our bank debt by $31.5 million. This decrease in bank debt contributed to our 41% decrease in total debt from $141 million as of December 31, 2023, to $83 million as of June 30, 2024. We also repaid $5 million of unsecured 1-year notes from related parties affiliated with our Board of Directors that were issued during the first quarter of 2024. Utilizing our ATM offering, we raised $27.9 million by issuing 3.9 million shares of our common stock during the quarter. We also successfully converted our remaining $11 million of senior unsecured convertible notes, including accrued interest with 2.1 million shares of our company's common stock. Taken together, as of June 30, 2024, our bank debt was $45.5 million.
Total liquidity improved to $60.7 million, and our leverage ratio was 2.12x. These improvements were supported by a $43 million prepayment for an 11-month forward energy sale, representing approximately 22% of our annual $6 million megawatt hour gold during the term of the contract. Through these strategic actions to bolster our balance sheet, we have established a solid foundation to carry us through the challenges of the near-term environment and position Hallador for significant growth and margin expansion in the years ahead. That concludes our prepared remarks. We will now open up the call for any questions.

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Question and Answer

Operator

[Operator Instructions]. Our first question is from Lucas Pipes with B. Riley.

Lucas Nathaniel Pipes
B. Riley Securities, Inc., Research Division

Brent, my first question is on the bilateral power agreements with data centers that you mentioned. I wonder if you could maybe speak a little bit to the type of organizations that have shown interest, how mature are they? What's the size? And also, what do you screen for from those potential customers? Are you looking for the best price? Are you looking for a specific credit profile? I would appreciate your thoughts on that.

Brent K. Bilsland
President, CEO & Chairman

So, we're talking to several different partners, our potential customers. They can range from investor-owned utilities, cooperatives, co-hosting data center developers. So those are the type of counterparties that we're looking at. As we said in the prepared remarks that we anticipate -- Look, all of these counterparties are trying to figure out how to build data centers as fast as they can. And so, they are looking at a major capital investment and they need power for a long period of time, right? They don't want to build these things and then find they can get power in the second or third year. So, as we said in the prepared remarks, we think that this will be a sale of the majority of our energy and capacity. And for a period of time, that exceeds the decade and length. So that kind of gives you the scale of -- if we're successful, this will be a major transaction, transformational to the company.

These deals aren't done, right? And they take a long time to negotiate because there's big dollars and a construction project typically on the other side of it. So, what are we looking for? We're looking for a counterparty that has very good credit, right? We want to know that they're going to be there at the end of this contract, not just at the beginning. And so, price likelihood of can we actually transact with the counterparty. And will their credit survive the test of time. Those are probably the 3 biggest attributes that we're taking into consideration.

Lucas Nathaniel Pipes
B. Riley Securities, Inc., Research Division

And you mentioned that these things can take a while. Any color in terms of how long it could take from here? I know you just mentioned there's a lot of wood to chop. But any perspective you could add that would be appreciated.

Brent K. Bilsland
President, CEO & Chairman

That's a great question, too. And we only control one side of the negotiation. And oftentimes, in the negotiation, you have 3 parties, right? You have ourselves, the wholesaler of power capacity. You have someone that like a Hoosier that has the right to sell industrial power that we have, an MOU to potentially sell through, and then you have the end user. And so, because there are 3 different groups typically to the transaction, our crystal ball on how long this all takes is a little more opaque. So, what does it feel like? It feels like I don't know, somewhere near the end of the year or Q1 of next year. That's what it feels like. But we'll just have to stay tuned.

Lucas Nathaniel Pipes
B. Riley Securities, Inc., Research Division

One other question for me. Just in terms of looking out to the second half of 2024 in the context of the first half performance. Obviously, power pricing has been softer. I thought you mentioned 1.6 million megawatt hours sold in the first half. But for the second half, where do you think that number should

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shake out? You mentioned somewhat higher, I think, July utilization rates, but gas prices are super weak. If you had to point to specific -- if you had to point to a range for generation, I would appreciate your thoughts on that.

Brent K. Bilsland
President, CEO & Chairman

Well, look, the market has improved from the standpoint of -- in March, we had gas inventory levels that were 38% above the 5-year average. That's just a staggering amount of gas that would sit around in storage. And so, the market -- gas price down, we believe, to incentivize it's used, right? And so, what's happening is, you have higher heat rate plants dispatching in front of old plants because we have just incredibly cheap gas. People tend to look at Henry Hub and the IMEX pricing, but really, Chicago Citygate is probably a better indicator for us, and it's been a discount even to those markets. So, a lot of sub-$2 gas in the first half of the year. So, the inventory levels have improved, right? So, at the end of July here, I think the 26th the last report, inventory levels had come down by 22% to 16%. And inventory levels were 16% above the 5-year average. So we still have a lot of gas, but we're a lot better positioned than we were at the beginning of the year.

The other thing is this, we're in the summer months, right? So, we had good heating demand in July. We should have decent heating demand in December. It's hard to say what the balance of the year will bring. We should see cooling demand again in sometime around Thanksgiving. So, when we look at the period of time we have left, we don't have any scheduled outages, whereas in the first half of the year, half of our plant was offline for 70 days. Now part of that was 1 unit. Part of that was the second unit. So, it wasn't like it was one unit. But when you combine those, there were 70 days only half the plant available to us, no scheduled outages in the back half of the year. So, if market prices call for that plant to run, it will run. We did 1.6 million megawatt hours roughly in the first half of the year. We've already exceeded 25% of that in July alone.

So, the market will be better. We should run more. And if you look at the price of gas, when you get to December, it's above $3. So, at those prices, not only do we dispatch more, we should start to see higher gross margins when we run the plant, right? So, more widgets, greater margins. And that's what we say when we think that we'll finish the year strong and start to return to more profitable times than we've seen in the first half of the year.

Operator

[Operator Instructions] There are no additional questions at this time. So, I'll pass the call back to the management team for any closing remarks.

Brent K. Bilsland
President, CEO & Chairman

I want to thank everyone for taking the time today to tune into our earnings call. I want to thank our management team. And thank you, everyone, for their interest in Hallador. Thank you.

Operator
That concludes today's call. Thank you all for your participation. You may now disconnect your lines.

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