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Hallador Energy Company NasdaqCM:HNRG

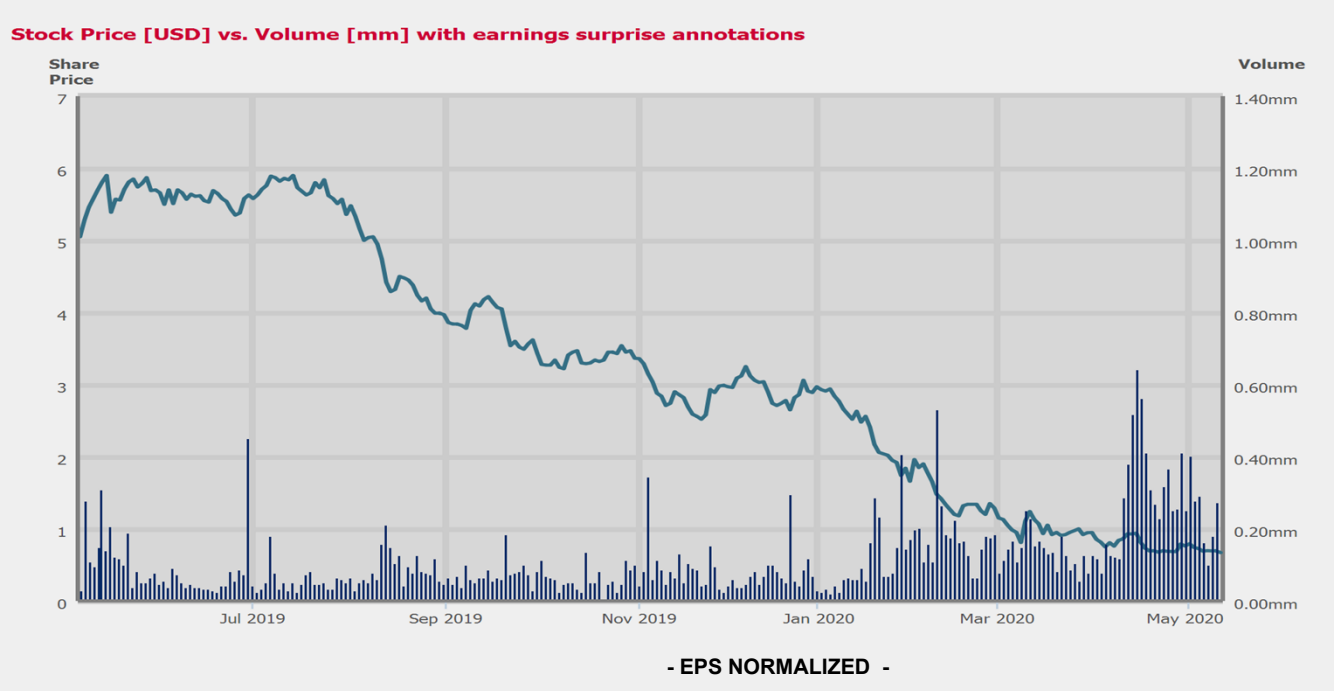
FQ1 2020 Earnings Call Transcripts

Tuesday, May 12, 2020 6:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2020-			-FQ2 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.02	(0.12)	NM	0.03	0.16	0.13
Revenue (mm)	59.90	62.54	4.41	59.90	259.70	261.10

Currency: USD
Consensus as of Apr-17-2020 12:01 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2019	0.12	(0.11)	NM
FQ3 2019	0.08	(0.12)	NM
FQ4 2019	(0.01)	(0.02)	NM
FQ1 2020	0.02	(0.12)	NM

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Call Participants

EXECUTIVES

Brent K. Bilsland
President, CEO & Chairman

Lawrence D. Martin
Executive VP & CFO

Rebecca Palumbo
Director - Investor Relations

ANALYSTS

Douglas Louis Dethy
D.C. Capital Advisors, Limited

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

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Presentation

Operator

Good afternoon, and welcome to Hallador Energy's First Quarter 2020 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded.

I'd now like to turn the conference over to Becky Palumbo, Director of Investor Relations. Please go ahead.

Rebecca Palumbo
Director - Investor Relations

Thank you, Grant. Thank you, everybody, for taking the time to join us today to discuss our first quarter 2020 results. As a reminder, this event is being webcast live, and you will be able to access a replay of this call on our website. We filed our first quarter 2020 Form 10-Q yesterday afternoon, and it is now posted on our website.

Participating on today's call is Brent Bilsland, our President and CEO; and Larry Martin, our CFO. Larry will begin today with a financial overview of the quarter, followed by Brent with comments on operations and market perspective. After they complete their remarks, we will open the line up for Q&A.

Today, 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.

And with that, I'll turn the call over to Larry to begin his quarterly review. Larry?

Lawrence D. Martin
Executive VP & CFO

Thank you, Becky. Good afternoon, everyone. I'm going to start with our operating results for the quarter. For the quarter, we had a net loss of $3.7 million or $0.12 a share. I would like to point out that $3.9 million of our losses were due to fuel hedges and interest rate swaps that are noncash. Our free cash flow for the quarter was $6.8 million. Our adjusted EBITDA $13.9 million. We decreased debt by $12.1 million for the quarter, and we paid dividends in February of $1.2 million or $0.04 a share.

I would like to go over the definitions of free cash flow as net income plus deferred income taxes plus depreciation, depletion and accretion and our ARO accretion, change in fair value of hedges and stock comp, less maintenance CapEx and the effects of our equity method investments. We define adjusted EBITDA as EBITDA plus stock compensation, ARO accretion and our change in fair value of hedges less the effects of our equity method investments in Hourglass Sands. At 3/31/2020, we had $168.1 million of bank debt. Our net debt with our net of cash was $160.1 million, and our debt to adjusted EBITDA leverage ratio was 2.93x.

I'll now turn the call over to Brent Bilsland, our CEO, for comments on the quarter.

Brent K. Bilsland
President, CEO & Chairman

Thank you, Larry. Thermal coal export prices collapsed in the second half 2019 pressuring domestic steam coal pricing. Now we do not participate in the thermal export market, but when competing tons sees going overseas, they return to the domestic steam market and compete against our tons. Additionally, natural gas prices marked their lowest levels in 21 years during the first quarter of 2020. Top that all off with most of the United States and the developed world closed and sheltered in place for 8 to 10 weeks during part of the first and second quarter, these challenges we have experienced in the last several months are of historic proportions.

Combination of these extreme events led us to take proactive steps to increase our financial capabilities, so that we can ensure consistency at a time when the world is experiencing great volatility. In anticipation of shipment delays and potential production interruptions, Hallador has amended its credit facility to provide $55.4 million in liquidity as of March 31; suspended its dividend; received a $10 million loan under the Paycheck Protection Program; and permanently closed

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its Carlisle Mine. We took these decisive actions as power demand has experienced a dramatic decline in the first and second quarter.

MISO, where 78% of our customers sell their power, is forecasting power demand in their territory to be 10% lower for 2020 on an annualized basis. But at times, demand has been off up to 30%. This has led to increased inventory levels at both our customers' locations and our mines. Thus, our revenue has been delayed until our customers can receive shipments. Accordingly, we have amended our credit facility to allow for higher levels of leverage, allowing us to access our full credit facility. As part of our credit facility amendment, we agreed to suspend our dividend until our leverage ratio falls below 2x debt to EBITDA.

On April 16, Hallador received a $10 million loan under the Paycheck Protection Program. According to the current guidelines from the SBA and the U.S. Treasury Department, Hallador has appropriately qualified and received said funds. Hallador is utilizing the PPP funds to pay 2 months of payroll and other covered expenses. Under the terms of the CARES Act, the company expects a portion of the loan to be forgiven by maintaining current staffing levels through June 30, 2020.

During the first quarter, we idled and permanently closed the Carlisle Mine after experiencing 18 months of negative free cash flow at the mine. This decision will further reduce our overall cost structure, maximize our per ton margins and reduce current and future CapEx by utilizing $23 million of Carlisle equipment at our Oaktown mine. As we reduce coal and parts inventories, we will generate significant cash to be utilized for debt reduction.

The idling and closure of the Carlisle Mine contributed to our elevated operating cost of $31.67 during the Q1 of 2020. However, Oaktown costs for the quarter were $29.92 per ton, in line with our prior guidance. Shipments for the quarter were 1.5 million tons or rounded it was 6.1 million tons annualized. We have another 5 million tons sold for the balance of the year, which we expect to be weighted towards the second half of the year. From a market perspective, we are encouraged by forecast showing a reduction in gas supply later this year. It is estimated that 40% of the 95 Bcf a day of U.S. natural gas production comes from associated gas produced in wells targeting oil production, which would translate to 38 Bcf coming from associated wells.

According to Evercore, active frac crews in the U.S., which we think is a helpful proxy for new oil and gas production activity, will decline 75% from the first quarter of 2020 to the third quarter of 2020. So 80 crews dropping to -- or excuse me, 315 crews dropping to 80 crews. As of May 4, Baker Hughes reported that rig counts for drilling and oil and gas have declined from 1,800 -- excuse me, 1,085 rigs at the end of 2018 to 408 rigs today, a 62% decline. Over the same time period, gas targets have declined 59% or gas targeted rigs have gone from 198 rigs to 81. Energy Ventures Analysis has stated that a 1 Bcf per day of gas supply decline equates to roughly 23 million tons of coal demand.

While analysts forecast all agree a decline in associated gas is imminent, a wide spectrum of an opinion exists regarding the amount of associated gas decline, the velocity of the decline and the duration of the decline. Forecast on the magnitude of the decline range from a conservative 4 Bcf per day to a high point of 16 Bcf per day. JPMorgan and Goldman Sachs have both recently forecast gas production levels will decline by 4 to 6 Bcf per day. But what if 16 Bcf is correct? The coal industry is not capable of bridging such a large reduction in gas supply if the 16 Bcf per day is correct.

During the last quarterly call, we discussed the magnitude of coalmine idlings and closures in 2020, in particular, for the Illinois Basin. Since January of 2019, 15 million tons of coal production has announced that is idled or closed, 80% of which has permanently closed. We estimate another 15 million tons of production has come off-line with no public announcement. In totality, roughly 30% of 2018's Illinois Basin production is not currently operating. And since our last call, we have seen numerous additional mines be temporary idled for several weeks at a time due to reduced shipments from lower power demand.

Some of these temporary idlings are likely to be extended. While difficult to currently project the amount of volume this takes out of the market, it is significant and shows a definite willingness to adjust production to current demand. So in summary, we certainly have experienced dramatic markets as of late, and we are impressed by the speed at which the gas and coal markets appear to be rebalancing. We believe that Hallador has taken the necessary steps to ride out the storm and continue to generate positive cash flow for its shareholders. No small task in these challenging times.
With that, I'll conclude my prepared remarks and open up for Q&A.

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Question and Answer

Operator

[Operator Instructions] Our first question will come from Lucas Pipes with B. Riley FBR.

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

I hope you all are doing well and staying safe. Brent, I wanted to touch on your comments on prepared remarks in regards to natural gas. Why -- and I wondered if you could just kind of reiterate, repeat some of the numbers you had mentioned in regards to the potential supply loss, but then also maybe expand on that in contrast to potential decline in demand. So what amount could have been lost due to lack of LNG demand, for example, lower power demand here domestically. So where would you put the net kind of fall on coal given the changes in the natural gas market?

Brent K. Bilsland
President, CEO & Chairman

So to repeat the numbers, we think that natural gas supply has been about 95 Bcf per day. On an annualized basis, 1 Bcf. According to EVA, it's roughly 23 million tons of coal demand. So from the supply side, we've seen different analysts come out and say that somewhere between 4 and 16 Bcf a day, which is a huge range, is how much gas supply will come off, majority of which is associated with associated gas, so somebody target an oil well and it also produced gas as a byproduct. When we look at the analysis, again, JPMorgan, Goldman Sachs, certainly others, they seem to be -- the bigger boys seem to be -- I would say, 5.5 Bcf seems to be the consistent number that we see. But to me, it's difficult because the moves in the market are just so extreme, right? Take oil prices from $60 to negative $37 a barrel, that hasn't happened before. To have reports saying that we're running out of oil storage space in the U.S. We've come close to that a handful of times. But -- and then on the gas side, one thing that's changed, why we're seeing some more dramatic swings is gas storage has not really increased in size compared to gas production. So gas storage now represents a smaller percentage of gas supply.

And then when does the market come back? I mean capital certainly has tightened for oil, gas and coal. So it's kind of this unique world where everything is coming to a grinding halt at the end of Q1, beginning of Q2. And then it feels like U.S. coal needs to be running pretty substantially at capacity sometime next year. Now getting from point A to point B is going to be volatile. And we sit there and say, well, okay, if U.S. coal production is running at 565 million tons of production, and we have estimates that are saying, we're somewhere between 104 -- if you took the 16 Bcf, it's 400 million tons of coal demand. That's not -- U.S. is not capable of producing that anymore. So from that perspective, we think it's going to be an interesting ride. And what we're basically saying is we see the light at the end of the tunnel. We just don't have a great feel for how quick.

Now you asked about LNG. There's LNG plants under construction. There's LNG that's backing up. 90% of LNG roughly is under contract, 10% is the spot market. LNG overseas, the KJM (sic) [JKM] markers certainly not in the money today. So how much demand has that taken off? I don't know that's certain. I mean, I think it could be up to 1 Bcf. But I don't think it's materially more than that. And I think there's plants still under construction. If there's an infrastructure bill, I think even more plants continue to get built. It's just an unusual time, look, because I mean the markets are really being pushed around at extremes. I think the positive that we have going is exports came back, winter was mild, gas prices hit 21-year lows, most of the world went on lockdown for 8 to 10 weeks, and we're still cash flow positive. We still have a pretty strong forward contract position. And so -- and we know that here we had gas prices -- the spot price for gas on April 2 was $1.55 and the gas price last night for January future was $3.02. So we see these extreme price disparities in such a short period of time, but it looks like to us, coal is going to be in the money next year. So you're going to see gas plant -- or coal plants dispatching in front of coal plants. What we don't have a strong feeling for is when does the coal buyer return to the market. Right now, they're choking on coal, but we know there's a transition point there where they look materially short coal. So that's why we're trying to be as assertive possible by -- we didn't give guidance on what we think sales are for next year. We've put as much liquidity. We've tried to put a lot of liquidity on our balance sheet just to make sure that we get to that light at the end of the tunnel, and we feel pretty good that we'd get there. So between...

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

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That's helpful. In terms of the -- kind of on that chain of thought here with the light at the end of the tunnel, what is unfortunately, again, a seeming overhang here for the thermal coal space is the amount of inventories on the ground at utilities. How much concern does that give to you? If it was push out, kind of the impact from these higher gas prices, 6 months, 12 months. Like in a way, like how much longer will it take for things to get tied in coal given the amount of coal inventories?

Brent K. Bilsland
President, CEO & Chairman

Well, in Indiana, we see Duke Energy is doing a decrement. So they're burning off their inventory at a time when gas is dispatching in front of coal. That's starting to flip in Indiana with where current gas prices are or going to be here in the next couple of months. So we feel that Duke is the largest utility in Indiana. We feel like they are doing the correct steps to get their inventories in line. We know of other utilities that are also doing decrements, so force running plants, burning off inventory. So we're hopeful that those actions kind of get us -- get the utility market back in balance from a coal perspective in Indiana towards the end of this year, okay. But that is -- we talked about because markets are moving such extremes, it's hard to get a good grasp on how much associated gas is coming on off, what's the amount of decline, what's the velocity of that decline, what's the duration of that decline, because those are big numbers, right? There's all sorts of different analysis out there. Some people are saying, well, the oil and gas industry is going to shut off its old wells. The old wells are producing more gas than the new wells. And so we've got to use 3.7 Mcf per barrel, so it's versus 2.3 for a new well. I mean, so it's really hard for anybody to get -- just not enough data points to be able to pinpoint when is the actual day. I think we're much better at saying it is heading in the right direction. Now there's uncertainty out there. There's just a lot of uncertainty out there, and that's why you've seen us try to pack on a bunch of liquidity onto our balance sheet just to make sure we ride out that storm.

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

Very helpful. Now looking at your contracted position for 2021, 5.1 million tons; 2022, 5.3 million tons. So assuming the case that things kind of stay pretty dismal, be it that yes, supply-demand, as you say, there's a ton of uncertainty. So in kind of the downside event where bull markets don't really tighten and try to stay depressed, could you run at that 5.1 million, 5.3 million ton level without a material impact to your production costs?

Brent K. Bilsland
President, CEO & Chairman

So we've closed the Carlisle Mine, and we're focused on the Oaktown mine, which is the lower production, lower cost profile. Now we've been running that. We've got 4 units running at Oaktown, I guess, capable of 7. And like I said, we've kept the cost under $30 a ton. I was happy with the numbers we saw in April out of it. So we feel pretty good about that. I certainly think we can do better if we can get volumes up. But the thing about these markets are, every time markets are high priced, I think it's going to last longer than it does. And every time markets are low price, I think it's going to last longer than it does. So we're preparing for the worst, but we certainly see this change in gas is very material in what's going to happen to pricing. And we've seen so much coal supply come offline. There certainly is going to be a rejigger period, right, where inventories are coming down and people are trying to get mines back online. But it looks like to me we're going to be materially healthier from a market perspective in 2021. And we certainly believe that we will make additional sales in 2021.

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

That's helpful. So like -- so you wouldn't, at this point, say, look, just take it down to 5 million tons or a $9 margin or something like that? You don't think that's a reasonable base case at this point?

Brent K. Bilsland
President, CEO & Chairman

I'm sorry, Lucas. I didn't -- you're a little quiet. So I didn't quite hear the question.

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

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No, I mean, it was essentially restating on my prior question. So at this point, you're not looking at like -- just running at your contract minimums, locking in like a $9 margin or something along those lines. You're still looking to maybe put now 6 million tons in the market, including your contracted tons. Is that kind of a takeaway...

Brent K. Bilsland
President, CEO & Chairman

I think that we are prepared to run at what our contract minimums are, but we certainly believe we will be making additional sales.

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

And then last question for me. In terms of the market out there, it doesn't seem like we've seen a ton of supply cuts yet, especially kind of given how bad it's been. And could you share your thoughts on what else you're seeing out there in the basin? Are mines closing down? And importantly, are they closing down for good? I think that's what the market really would like to see here.

Brent K. Bilsland
President, CEO & Chairman

Well, we've seen significant companies in the space idle mines for 4 to 6 weeks. I know one supplier had 5 of their 7 mines down for 4 weeks. They brought 1 on last week. The remaining 4 mines, I think, they're now in week 6 of those mines coming off-line. And when they're bringing them back, it looks like to us they're bringing them back at 55% of the original capacity. So I think they're doing prudent decisions to rebalance market and get inventories in line. And that's kind of what the market misses to some degree is that, oh, the mine is back online. Well, yes, but it's that back online with half its units running or longwalls that are running 1 shift a day, 2 days a week. And we've seen this from multiple producers. And we saw -- just last week, we saw another permanent mine closure announcement from a competitor in the state of Indiana. So we know there's some privates that are on life support. They're not paying their vendors and claiming that they will. But eventually, the vendors say enough. So we do think there's been, like I said, in our prepared remarks, we think 15 million tons has been announced. About 80% of that is permanent. I'd say maybe that's -- that was our data point from March. I'd say there's been a couple more permanent announcements since then. I think some of the bankruptcy proceedings that are going on it's -- they all start out as Chapter 11, and some of them end up in Chapter 7. And one of the larger ones that's currently in bankruptcy probably comes out in Chapter 11. But if they come out in Chapter 7 then you would see material reductions in volumes in the market. So just such an unusual time, because there's just such extreme market factors at play. And most people are, I think, factoring in a conservative reduction in gas. But I ask the question, well, what happens if it's not a conservative number? What happens if it's closer to 10 Bcf? I mean when all these mines try to go hire back at the same time, there's not going to be enough people. So that's the case for dramatically higher prices. It's just -- it's all going to come down to what velocity does this all happen. But again, we're not very good at predicting what data that's going to happen, but we certainly think the curve is heading in the right direction.

Operator

[Operator Instructions] Our next question will come from Douglas Dethy with D.C. Capital.

Douglas Louis Dethy
D.C. Capital Advisors, Limited

Could you just give me an idea in terms of, I guess, your cash flow forecast for the year, not so much maybe on the EBITDA, but just on the amount going out between the interest expense, capital expenditures and any other major items that should be considered?

Lawrence D. Martin
Executive VP & CFO

Well, as stated in our CapEx or in our quarter, we expect to spend $20 million on CapEx for the year.

Douglas Louis Dethy
D.C. Capital Advisors, Limited

Okay. And how about on the interest expense? What do you think that will be for the year, just a range?

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Lawrence D. Martin
Executive VP & CFO

11% to 12%.

Douglas Louis Dethy
D.C. Capital Advisors, Limited

11% to 12%, okay. And the -- so that's down from last year, is that correct?

Lawrence D. Martin
Executive VP & CFO

Yes. I mean we paid our debt down a little bit, and we expect to keep paying our debt throughout the year. So I'm not sure it's down a whole lot. You got to remember, our interest rate swap is included in interest expense. And it has went negative every quarter last year. You got to look at that interest rate swap amount that's -- it's disclosed in the footnotes and it's in the cash flow.

Douglas Louis Dethy
D.C. Capital Advisors, Limited

And have you given any guidance as to the cash impact of the government program? Obviously, you've got the money in, but what the net income -- what the net effect will be by the end of the program? Or will that depend on -- I mean based on your expectations question?

Lawrence D. Martin
Executive VP & CFO

I mean they're still working on guidance for that. It seems like the rules change every day. So we are not giving any guidance on that for now. When it changes, we may put out guidance. But for now, we're -- I mean they're changing the rules every day on that, so.

Douglas Louis Dethy
D.C. Capital Advisors, Limited

Okay. I mean some of the changes I've talked about changing with respect to retail establishments. I said it wasn't very well set up for that. Is there anything specific with regards to your industry that is undergoing change?

Brent K. Bilsland
President, CEO & Chairman

Well, I think that we came out in our original press release and felt that 80% could be forgiven. That was our initial guidance. Since that time, we've seen different guidance. Supposedly, there's more guidance coming yet on the SBA -- from the SBA. So just to be conservative, we've tried to decline making estimates as to what that would be -- I think that was our original analysis. I don't know that we've seen anything materially change from their guidance, but that doesn't mean we won't see something at the end of the day today, so.

Douglas Louis Dethy
D.C. Capital Advisors, Limited

Right. That is certainly understandable. And just the amount that you did receive was -- how much was it? I know you had it in the release, but I don't have it right in front of me.

Brent K. Bilsland
President, CEO & Chairman

$10 million.

Douglas Louis Dethy
D.C. Capital Advisors, Limited

$10 million, okay.

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Operator

[Operator Instructions] At this time, I'm showing no more questions in our question queue. So this will conclude the question-and-answer session. I'd like to turn the conference back over to Brent Bilsland for any closing remarks.

Brent K. Bilsland
President, CEO & Chairman

I want to thank everyone for taking the time and join our call today, and we look forward to talking to you next quarter. Thank you.

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

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