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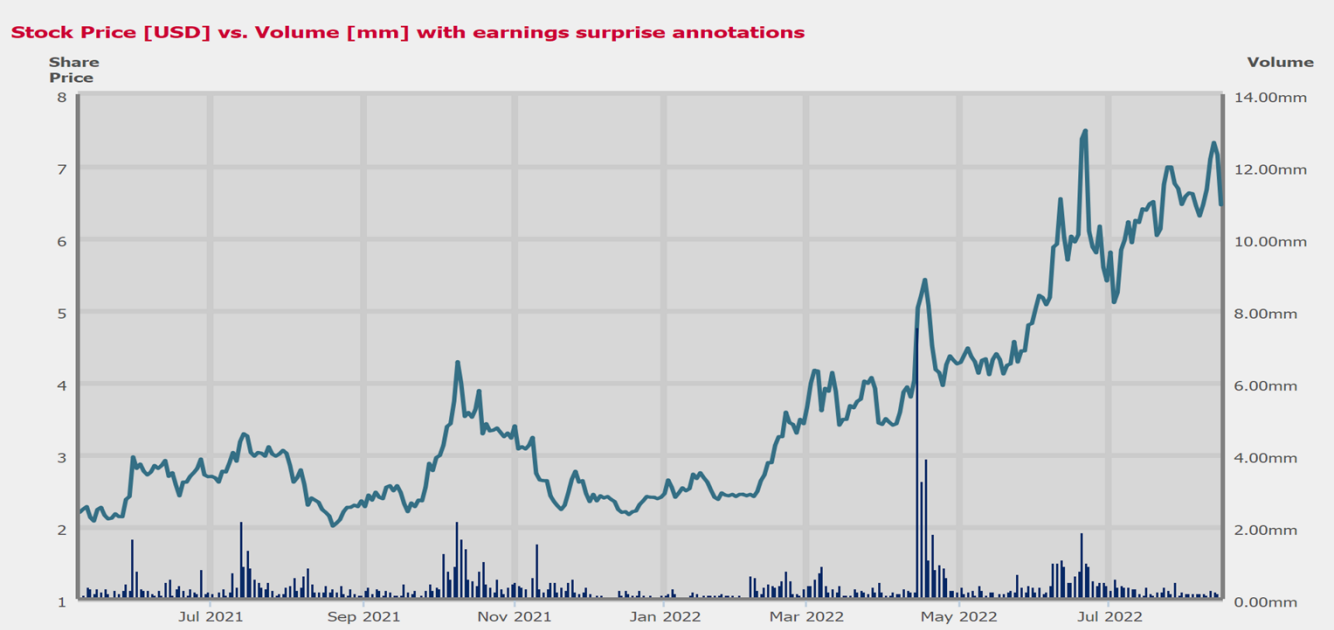
Hallador Energy Company NasdaqCM:HNRG FQ2 2022 Earnings Call Transcripts

Tuesday, August 16, 2022 6:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2021-			-FY 2021-			-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	(0.02)	NA	NA	0.11	NA	NA	0.10
Revenue (mm)	66.70	NA	NA	248.90	NA	NA	280.80

Currency: USD
Consensus as of Nov-16-2021 3:44 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	0.06	(0.10)	NM
FQ3 2021	0.01	(0.07)	NM
FQ4 2021	(0.02)	(0.32)	NM

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Table of Contents

Call Participants 3
Presentation 4
Question and Answer 6

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Call Participants

EXECUTIVES

Brent K. Bilsland
President, CEO & Chairman

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

Rebecca Palumbo
Director of Investor Relations

ANALYSTS

John Moran;Robotti & Company;Senior Investment Associate

Nick Giles;B. Riley Securities;Equity Research Associate

ATTENDEES

Unknown Attendee

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Presentation

Operator

Thank you for standing by, and welcome to the Hallador's Second Quarter 2022 Earnings Call. My name is Sam, and I will be your moderator for today's call. [Operator Instructions]

I'd now like to hand the call over to Rebecca Palumbo, Investor Relations. Rebecca?

Rebecca Palumbo
Director of Investor Relations

Thank you, Sam, and thank you, everybody, for taking the time to join us on today's call. Yesterday afternoon, we released our second quarter 2022 financials and operating results on Form 10-Q that is now posted on our website. With me today on this call is Brent Bilsland, our President and CEO; and Larry Martin, our CFO. After our prepared remarks, our team will be available to answer your questions.

Before we begin, please note that the discussion today may contain forward-looking statements that are statements related to future, not past events. In this context, forward-looking statements often address our expected future business and financial performance. 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.

For example, our estimates of binding costs, future sales, legislation and regulations. In providing these remarks, we have no obligation to publicly update or revise any forward-looking statements whether as a result of new information, future events or otherwise may be required by law. For a discussion of some of those risks and uncertainties that may affect our future results, you should see the risk factors described from time to time in the reports we file with the SEC.

As a reminder, this conference call is being recorded. In addition, a live and archived webcast of this earnings call is also available on Hallador's website. [Operator Instructions] The toll-free number is (844) 200-6205. Access code 393229.

Now with that, I'll turn the call over to Larry.

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

Thank you, Becky, and good afternoon, everyone. Today, we're reporting our second quarter operating results. And before I get started, I want to define adjusted EBITDA as operating cash flows plus current income tax expense, less effects of certain subsidiaries and equity method investments, plus bank interest, less the effects of working capital period changes, plus cash paid on asset retirement obligations, reclamation, plus other amortization.

We had a net loss for the quarter of $3.4 million or $0.11 a share. Our year-to-date loss was $3.5 million or $0.44 a share. Our adjusted EBITDA was $11.5 million for the quarter, $14.1 million for the year, and we increased our debt by $10.7 million for the quarter and $19 million for the year. Our bank debt at June 30 was $130.7 million. Our net debt was $121.9 million. And our leverage ratio, which is debt to adjusted EBITDA, was 3.27x.

I will now turn the call over to our CEO, Brent Bilsland.

Brent K. Bilsland
President, CEO & Chairman

Thank you, Larry. In the second quarter, our accomplishments exceeded our expectations. We were successful in returning our operating cost structure to historical levels. We contracted for 2.2 million tons of forward sales at over $125 per ton, dramatically increasing our future sales prices. We were successful in raising a total of $29 million over the second and third quarter to add to our liquidity. All 3 of these events lowering our cost structure, increasing our sales prices and adding to our liquidity greatly improved our current and future financial position.

Also during the quarter, we made significant progress towards closing the acquisition of the Merom power plant within the next few months, pending governmental and financial approvals.

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As we look at operating results, 1.6 million tons were shipped during the quarter at an average sales price of $40.23. This was $1.17 per ton lower than Q1 and is expected to be our lowest sales price quarter for the next several years as we will experience roughly an $8 per ton increase in the third and fourth quarter, significantly more than that next year.

Q2 production costs were $31.83. This represents a $7.71 per ton decrease over Q1. Productivity at the mine improved dramatically, accounting for the majority of the cost improvement.

During the second quarter, our operating cash flow was negative $2.7 million due to increases in accounts receivable, inventory, parts and supplies and cash spent on ARO reclamation. Our bank debt increased by $10.7 million, which as of June 30 stood at $130.7 million. Liquidity was $9 million, and our leverage ratio came in at 3.27x.

To put ourselves in better financial footing and to increase liquidity, we issued $10 million of convertible notes during the second quarter, followed by an additional $19 million of convertible notes in the third quarter, equaling a total of $29 million. $10 million of the convertible notes were converted to equity during the second quarter.

The company was successful in executing an amendment with our banks modifying our debt-to-EBITDA covenant and our debt service covenant for Q3. We project being fully in compliant with all future covenants.

During the second and third quarter, we are successful in executing forward contracts. Sales for coal averaging prices in excess of $125 a ton for the 2022, 2023, 2024 and 2025 timeframe. These new contracts will dramatically improve our average sales prices. If you look at the first half of this year, we have averaged $40.77 per ton. In the last half of this year, we expect to average $49 per ton. I expect that price increase to be a little bit more heavily weighted towards the fourth quarter than the third. When we look at 2023, we expect our average sales price to be at $58 per ton. So this, in effect, will more than triple our margins going forward.

In our prior earnings call, we had discussed our plan of taking up to 25% of our 2023 Oaktown production to the Merom power plant as we felt that was the most valuable use of those tons at that time. However, soon after disclosing those plans, market conditions changed significantly, and we felt it was better used to sell the majority of those tons to third-party customers. I think this is a prime example of the optionality that Merom plant will afford us once we close on the transaction. If Merom is the best use of tons, which I think the majority of the time it will be, that's where we'll take them. But like we just showed, if third-party customers are willing to pay more than we feel are worth at the plant, we're willing to execute on that plan as well.

These contracts allow Hallador to generate $160 million of adjusted EBITDA in 2023, and we expect very little profit from Merom in '22 and in '23 as the plant is still limited. However, the cash flow will be so great that we project that we will be net debt free before the end of next year. So we're very excited about that. If we're able to alleviate Merom fuel limitations, there's further upside to Hallador's 2023 adjusted EBITDA.

Looking at the closing of the acquisition, we feel we've made great progress towards closing the Merom acquisition on both the regulatory and the financial front. We anticipate closing will occur in the next couple of months, subject to obtaining our final government and financial approvals. Our team, our operating partner in CAMS, our partner in ACES have all worked very hard to ensure a successful transition and for Merom to perform as it should on day one.

We've never been more excited about the future of Hallador. We're thrilled of our new sales contracts. We feel comfortable that we are on solid ground financially, and we look forward to the promising opportunity the Merom power plant brings Hallador and its shareholders.
So with that, I'll open up the line for questions and comments.

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Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Lucas Pipes with B. Riley Securities.

Nick Giles;B. Riley Securities;Equity Research Associate

This is Nick Giles asking a question on behalf of Lucas. What does the $160 million of EBITDA assumed for volume and cost, respectively?

Brent K. Bilsland
President, CEO & Chairman

Okay. I'm sorry, I didn't catch your name.

Nick Giles;B. Riley Securities;Equity Research Associate

Yes. This is Nick Giles asking a question on behalf of Lucas.

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

We're cost...

Brent K. Bilsland
President, CEO & Chairman

Yes, Larry, I don't want to misspeak on the cost. I know that we're bringing on some additional production next year out of the surface pit that is a little higher cost, and we've reported that number going forward as -- Larry, I'll let you fill that in.

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

$34 to $35 in the fourth quarter, and -- well, $36 for next year.

Nick Giles;B. Riley Securities;Equity Research Associate

Got it. Got it. Okay. That's helpful. And then a follow-up there. Does the $160 million, does it require the transaction to close at Merom? Or is it independent of the power plant acquisition?

Brent K. Bilsland
President, CEO & Chairman

That's independent. As we've said, we expect very little profit out of the plant unless we are able to procure additional tons for the plant, which we are working on. So if we are successful in securing additional tons for the 2023 year, then there's upside to the profit potential beyond just the $160 million.

Nick Giles;B. Riley Securities;Equity Research Associate

Great. Great. Okay. That's clear. And then I think last one for me. Do you need to make any investments in mine infrastructure equipment, hiring any labor to get to that $160 million target?

Brent K. Bilsland
President, CEO & Chairman

Well, we've made great progress on the hiring front. That's an area that we've struggled since I think our initial plan started in September of 2021 that we had a goal of hiring an additional 200-plus employees. And I think we've now -- last count, we've added about 190 of those. So we're almost to our target number that we want to be at.

As far as on the equipment front, no, we have the equipment. We have our -- well, I take that back. We have added some CapEx to reopen a surface pit in Freelandville, Indiana, and we've added a little bit of surface equipment to that -- to the company to bring

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roughly 600,000 tons out of that pit for the -- for basically fourth quarter of this year and the balance of next year. So coal prices we're seeing at levels that are just, quite frankly, unheard of, and we're seeing a little bit of turn to that as well. And so it justify bringing on a little bit of higher cost production, which is why we're showing our cost jumping up in the $36 range because it is extensive surface mining coal. But when you can sell, as we've said, over 2 million tons north of $125 a ton, those margins work.

So gas prices have stayed strong. European prices have stayed strong. I think I saw a price for power in Europe next August of $600 a megawatt hour. I mean as long as that keeps happening, you're going to see U.S. coal flow to Europe, and that's going to keep our market pretty tight. So -- and we're seeing an extension of a lot of coal-fired power plants that have announced to retire. I can name 3 kind of in our backyard that have all now extended saying, all right, we're going to put a couple of more years on these plants just because capacity is really hard to find, which is why capacity prices went from almost nothing to legal limit in this past auction. So we still see more power plant retirements announce, which is going to keep capacity prices tight and elevated.

We still see disruption in Europe, which is also keeping prices elevated, and we're still seeing really for the next 3 years pretty high natural gas prices. So all of those things are good for Hallador's business, and we're just tremendously excited about the future of being able to profit both as our coal company and with the addition of the Merom power plant, which we're feeling good about that transaction getting closed here shortly.

Nick Giles;B. Riley Securities;Equity Research Associate

Got it. Got it. That's very helpful, really appreciate all the detail there. I guess just one last one would be, do you have a -- do you put some numbers around the incremental CapEx that you mentioned?

Brent K. Bilsland
President, CEO & Chairman

Yes, I'll refer to Larry here so I don't misquote the number.

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

Yes. So I think the incremental CapEx for the surface mine is about $6.5 million.

Operator

The next question comes from the line of John Moran with Robotti & Company.

John Moran;Robotti & Company;Senior Investment Associate

I had -- on the 2.2 million tons that you sold during the quarter, you have a disclosure on these forward sales in all of your 10-Qs that references customers options or ability to reduce tonnage or increase tonnage. How subject -- how much of that would come into play on the new tons that you sold? For example, if the coal price collapses next year, can these customers walk away from portions of that -- of those contracted tons?

Brent K. Bilsland
President, CEO & Chairman

The 2.2 million tons I referenced, those are fixed tons. There's no plus/minus on the volumes.

John Moran;Robotti & Company;Senior Investment Associate

So that's just fixed price and no ability to get out of that?

Brent K. Bilsland
President, CEO & Chairman

Correct.

John Moran;Robotti & Company;Senior Investment Associate

What about on the 2024 to 2027 volumes? How much of those that were in place prior to this -- these new contracts? Would be subject to increasing volumes at, I guess, what I'd call, stale pricing, if any?

Brent K. Bilsland

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President, CEO & Chairman

So we disclosed, what, 7 million tons of sales, I think, in the '24 through '27. We were successful in selling some of those 2.2 million ton, like I said, it was in that '22, '23 to '24 and '25 time frame. Anything beyond that was legacy. We do have -- hang on, let me look some up. Yes, the legacy out in that '26-'27 timeframe is on price. So we have volume commitments but not pricing commitment. So you see those pricing come up.

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

And maybe 200,000 to 300,000 of that 7 million is -- it can go up or down by $200,000 or $300,000.

John Moran;Robotti & Company;Senior Investment Associate

Okay. And the rest of it is either unpriced or fixed?

Brent K. Bilsland
President, CEO & Chairman

Correct.

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

Correct.

John Moran;Robotti & Company;Senior Investment Associate

Okay. Great. And then just a question about Merom. So assuming that closes, as you expect, what will that look like next year? You said you're fuel limited. Can you say -- I assume some of that information is public. I don't know where to find it, but -- so they must have contracts with third-party producers. So I guess there is no coal available for next year. So can you say...

Brent K. Bilsland
President, CEO & Chairman

I think there's been -- there is some fuel purchase for that plant. I feel that fuel will be dedicated to generating Hoosier's electrons, and we've set a price with them on that. But we expect, again, that price -- that plant to run at low capacity factors. It will run. It will make a small profit. But -- John, you were the guy on the last call, who said, if you can sell coal versus take it to the plant at these higher prices, why wouldn't you do that? And I think it was a couple of nights later we saw an offer to us at pricing that was above our expectations. So we made the decision to do just that.

And so instead of taking a couple of million tons to the plant, we took it to the market. So like I said, it's not that there's no fuel for the plant, it's just fuel limited. So it's not going to run a lot of hours. We do see some opportunities to acquire additional tons to bring to the plant, but those deals are not finalized, and we'll assume they're not going to happen until they do. All we want to do...

John Moran;Robotti & Company;Senior Investment Associate

Yes, that decision -- decision seems like it...

Brent K. Bilsland
President, CEO & Chairman

All we wanted to really point out was, traditionally, we've spent about $50 million of EBITDA. We are now fully contracted for 2023 and the prices we're talking about and the production cost numbers that we're expecting, we think that will generate $160 million of adjusted EBITDA, which -- so we basically have tripled our business. That will generate enough cash flow to pay off all of our debt almost here in the next, let's just call it, 13 months. So...

John Moran;Robotti & Company;Senior Investment Associate

I think the decisions seem like it makes a lot of sense. I was just trying to figure out, for example, if that -- if the plant will be running at 25% capacity and you make a little bit of money at breakeven in that. I just don't know what the Merom economics look like from that standpoint at all. So -- or can you say...

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Brent K. Bilsland
President, CEO & Chairman

We haven't released any of the economics on the Merom plant, and we will not do that before closing. All I'll tell you is, correct, it's going to run at a very low capacity factor. There's parts of the year that will run more than others. So it gets a little confusing as to why it did run harder in the first quarter than it ran in the third quarter. But so that -- but at the end of the day, if we are successful in finding more fuel for the plant, there is upside to our projections, right? Power price is still pretty healthy. Capacity prices are extremely healthy. And so for all those reasons, we're excited about the potential of this company. I mean you're talking about a company that has a market cap of a little over $200 million and just going to do $160 million of EBITDA. It's got to pay off $131 million of bank debt in that timeframe. I think that's punching above our weight.

John Moran;Robotti & Company;Senior Investment Associate

All right. I also want to just complement the company and the directors on the capital raise. I don't think anybody likes dilution, but it seems like it's a little over 10% and is at a decent price in reasonable terms. So anyway for what it's worth.

Brent K. Bilsland
President, CEO & Chairman

I appreciate that. Thank you, John.

Operator

[Operator Instructions] We have a question from Robert Baker, private investor.

Unknown Attendee

I was -- well, my first one, I was curious about the 2.2 million tons priced at $125 a ton. Just any context you can give around that as far as is that kind of more where the overall market is currently pricing at? Was it a customer who was extremely short, just trying to lock in tons or anything you can provide on that would be appreciated.

Brent K. Bilsland
President, CEO & Chairman

Well, we actually transacted with 5 separate customers. The market is backward dated, meaning that coal in '22 is more valuable than '23, and coal in '23 is more valuable than '24. What we're seeing generally is, I think, utilities are pausing from buying a little bit. They're going to get into the RFP -- go out for RFP here in September, October. And to where market prices are, I think we're trying to get a handle on what railroad and transportation performance is going to be like in the third and fourth quarter. I mean it's one thing to buy tons, it's another thing to actually get them shipped.

CSX has done a reasonably decent job thus far. I would say, about 85% of everything that we have scheduled has been shipped, but our moves are typically a little simpler than some of the other people out there trying to go to export as gas -- we basically keep seeing gas pricing, high-price gas keeps extending out further and further. And as that happens, we think that adjust power prices up further and further. So it will push higher pricing out the curve is what we think will happen.

As long -- and again, as long as there is disruption in the market, meaning -- and we had a tight market. And then Russia and Ukraine's altercation, whatever you want to call it, that has created enormous disruption to the market. Again, Russia is the third largest coal exporter in the world, and now you got Europe basically saying, we won't take those BTUs. They're the largest natural gas exporter of world. Europe saying, we won't take those BTUs or we're not -- what Europe is saying or west is saying, I don't know. Those deals aren't flowing, and so Europe is getting those from the United States. We've seen several contracts for LNG to leave the United States and go to Europe and other countries.

There's been just an enormous amount of activity of new contracts being signed is a 20-year term contracts. So that removes a lot of gas from the United States, which then kind of -- gas is a competitor to coal. So we've gone through this period which is where our legacy contracts came from almost 5 years, 6 years, 7 years of really cheap gas. And now we've kind of entered into this environment where we -- the price of gas has doubled or tripled, depending on what time frame you're looking at. So because of that, the market then looks to get more of its electrons from coal, and there really hasn't been a dramatic supply response from coal production due to -- nobody is putting in new mines. It's hard to hire people. It's the higher to get capital. All those reasons has kind of kept a lid on -- we've seen some supplier response, but it hasn't been dramatic, and you're not going to see the U.S. coal production double. It just isn't going to happen.

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So from that perspective, we're excited about the future. We're seeing pricing that we've, quite frankly, never have seen before. And selling coal versus in the mid-$30s versus selling coal in the $130s, it's a magical experience. You do not sell very much of it, but there's all sorts of pricing charts out there to show where it's all trading at. Transportation is hard, but it is moving. And so we think as long as gas and as long as there's disruption in the market, we're going to see pricing continue to push out the curve.

Now will it stay above $125 a ton, your guess is as good as mine. High prices can secure high prices, but we don't see -- we don't think it's going back to $30s anytime soon. So for that matter, we think that we're seeing average prices now up around $50 to -- our average price moves to $58 next year. We make great margins with that. We produced a hell lot of cash flow with that, and we just see a lot of opportunity, particularly with the addition of the plant. That's a very beneficial thing to our company, and we're looking forward to getting that transaction behind us.

Unknown Attendee

So my next question, you kind of already started to answer when you mentioned CSX doing about 85%. And there was in the Q3 '22 activity, you did mention the delivery of all the tons could be delayed by transport logistics. I was wondering if you could elaborate on that a little bit whether you have said one rail line in particular or kind of all of them. Or just any more detail or elaboration on that.

Brent K. Bilsland
President, CEO & Chairman

I think that all forms of transportation are struggling, whether that's CSX, NS or truck. Everybody is running at their maximum. So we sell the coal, we produce the coal, but it's our customers' responsibility to deliver the freight to us. So once we're loaded -- once we load the transportation they provide, that's when title transfers, and that's when we effectively have made a sale. So one of the things we have to be diligent on is to make sure that we're working with our partners, the CSX primarily and trucking companies, to make sure that our product is flowing to the customers.

And what I'm saying is, there's been a lot of press out there of a poor railroad performance. I've usually found that the railroads take a little time to get wound up, but once they get going, they performed pretty well. They've struggled with COVID. They've struggled with hiring people just as we have. We have seen on our front, it's gotten a little easier to hire people here, I would say, in the last 2 months. Is that a reasonable success that we're experience and others aren't? I don't really know. But from our standpoint, we've made gains there. So anyhow, we feel good about transportation at this point. It is something we're keeping an eye on.

Unknown Attendee

Okay.

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

And just to be clear, when we said all of our tons, we didn't mean every single ton could get delayed. We met all of our contracts to any -- to all of our customers could have some delays. We didn't mean 100% delays.

Unknown Attendee

No, no. Okay. Yes, I didn't -- I wasn't interpreting it at 100%. I just said, yes, delivery of -- well, I guess, I wasn't sure if it was just referring to the 2.2 million tons or potentially all tons could have -- how would I want to -- yes, I wasn't quite sure if it was specific to the 2.2 million...

Lawrence D. Martin
CFO, EVP & President of Sunrise Coal

Yes, there is a percentage of any ton we deliver that could be delayed. But I mean, it's not -- it's just every customer. As Brent said, all transportation is having issues now. So any customer we have could have some carryover or delays this year They are picking it up and doing a lot better.

Unknown Attendee

Okay. All right. That's good. Another question regarding labor needs. I think it was -- I hope, I have the name right. Nick asked about it, and you had mentioned that you'd been able to hire 190 of 200 employees. And I just wanted to clarify, was that 190 of 200 that you need to hire for Oaktown and separate from the hiring you have to do for Prosperity and Freelandville?

Brent K. Bilsland

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President, CEO & Chairman

That's correct. I think we want to add 210 at Oaktown. We've done about 190, 185 of that, something like that. So just to try to give you a scale of -- we're not quite where we need to be at Oaktown, but we're getting much, much more comfortable with -- on the hiring front. We've had much higher turnover with new hires than we have with historical employees. I think we are starting to see some experienced people come back, people that have left to try a steel company or try to work at a car manufacturer or something like that. We're starting to see those -- some of those people found that the grass isn't greener on the other side of the fence. So they've come back, which is great.

Those are people that know the drill and are very efficient when they show up. Correct, we will be hiring some people associated with the surface mines, both at Prosperity and at -- but you got to think about it this way. I mean so we're winding down Ace as it mines out, and we're winding up Prosperity and Freelandville. So some of those people will be moved from Ace and some of those people will be new hires. We found it's much easier to hire surface miners than undergrounders. So we haven't really experienced any trouble with that. Where we've struggled over the last year has been to hire undergrounders and keep them.

Unknown Attendee

Okay. I understand. All right. And then last question. I was wondering, you mentioned the possibility of being net debt free at some point in 2023. As that progresses throughout the year, what thoughts, if any, the Board has regarding what to do with cash flow as leverage comes down? And I mean in terms of either dividends or buybacks or so forth? Or...

Brent K. Bilsland
President, CEO & Chairman

Yes. I think at this juncture, we've been raising money to make sure that we have enough liquidity to get to our high-priced contracts. We want to get the Merom plant closure behind us to make sure there's no surprises there. And we'll see what the opportunities bring next year as far as the room for additional investment at the plant or are there other plants that can be acquired or does it make sense to buy in stock. Those are all things that we'll lay out what the opportunities are next year and address those with our Board at this time. But to date, we're not in the mode of buying in stock.

Operator

[Operator Instructions] That concludes our Q&A session for today. I'll hand the call back to Brent for any concluding or additional remarks.

Brent K. Bilsland
President, CEO & Chairman

Well, thank you, everybody, for their time, and we look forward to executing on all the things we've laid out today. So thanks again, and we'll talk to you next quarter.

Operator
That concludes the Hallador's Second Quarter 2022 Earnings Call. Thank you all for your participation. You may now disconnect your lines.

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