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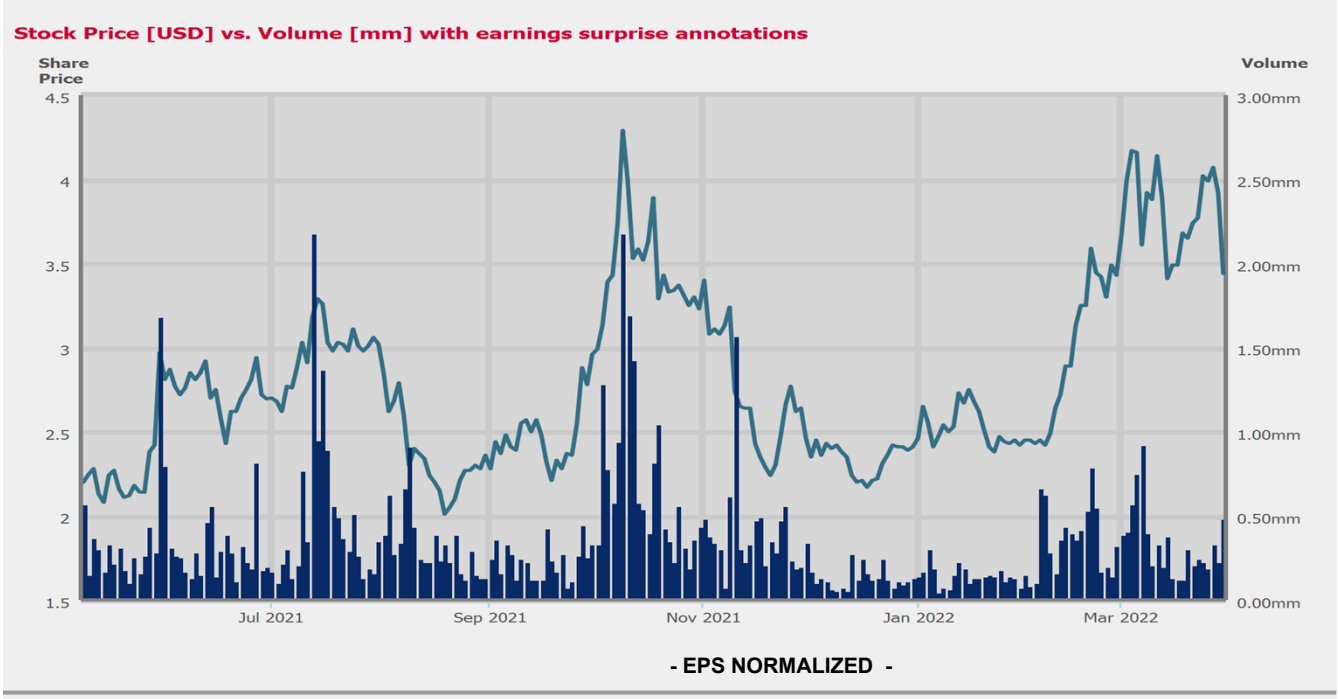
Hallador Energy Company NasdaqCM:HNRG FQ4 2021 Earnings Call Transcripts

Tuesday, March 29, 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)	(0.32)	NM	0.11	(0.51)	NM	0.10
Revenue (mm)	66.70	65.51	▼ (1.78 %)	248.90	247.67	▼ (0.49 %)	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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Call Participants

EXECUTIVES

Brent K. Bilsland
President, CEO & Chairman

Lawrence D. Martin
CFO & President of Sunrise Coal

Rebecca Palumbo
Director of Investor Relations

ANALYSTS

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

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Presentation

Operator

Hello, and welcome to Hallador Energy Company Fourth Quarter 2021 Earnings Call. My name is Elliott, and I'll be coordinating your call today. [Operator Instructions]

I'd now like to hand over to our host, Becky Palumbo, Investor Relations. Please go ahead when you're ready.

Rebecca Palumbo
Director of Investor Relations

Thank you, Elliott. Thank you, everybody, for taking the time to join us today. As a reminder, this event is being webcast live and the replay will be available on our website later today.

Yesterday afternoon, we released our fourth quarter 2021 financial and operating results on Form 10-K, followed by a press release containing certain financial metrics, which are now posted on our website. Today, we will discuss these results and our perspective on market conditions and outlook. Following the prepared remarks, the call will open up to questions.

This call may contain forward-looking statements that is 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 mining costs, future cost sales, legislation and regulations relating to the Clean Air Act and other environmental initiatives.

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, except as may be required by law. For a description 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.

So today -- on today's call, we have Brent Bilsland, our President and CEO; and Larry Martin, our CFO.

And with the preliminaries out of the way, I turn the call over to Larry.

Lawrence D. Martin
CFO & President of Sunrise Coal

Thank you, Becky, and good afternoon, everybody.

First, I want to get a definition out of the way. We define adjusted EBITDA as operating cash flows, plus gain on extinguishment of our PPP loan, plus current income tax expense, less the effects of certain subsidiaries and equity method investments, plus bank interest, less the effects of working capital period changes, plus other amortization.

So for the year ended December 31, 2021, we had a net loss of $3.8 million or $0.12 a share. Our adjusted EBITDA was $50.3 million, and our bank debt decrease was $26 million. At the end of '21, we had $111.7 million of bank debt. Our net debt with our cash on our balance sheet was $109.2 million, and our leverage ratio, which is debt to EBITDA, was 2.34x.

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

Brent K. Bilsland
President, CEO & Chairman

Thank you. As we reflect on 2021 and look forward to 2022 and beyond, we feel that last year was the year the economy reopened. 2022 will be the ramp-up year and integration of our soon to be acquired Merom Power Generation Station. But 2023 and the years following appear to have the potential to be fantastic for the Hallador shareholders.

But first, let's review 2021. We shipped 6.2 million tons and produced 5.8 million tons of coal during the year. Pricing for new business in Q1 was terrible, and we chose not to participate in making new sales at that time. But as the year wore

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on, the market strengthened dramatically. We chose to make forward sales for the years 2022 through 2026 totaling 5.8 million tons, with 4.6 million of those tons being delivered over the next 3 years.

In the fourth quarter, as markets improved, we began focusing on increasing our production, ramping from 5.8 million tons of production to our target of 7 million tons, a 21% increase.

To date, we have increased our head count by 17%. However, productivity increases have been challenging as when you take turnover into consideration, we have a lot of new employees that require extensive training.

Additionally, we mined through a handful of difficult areas to enable setting up our underground for additional units of production. Our Ace in the Hole Mine is reaching the near its reserve life, resulting in higher than historical costs. Ace will mine out in a few months, and we will open a new pit, which will resolve lower mining costs.

In spite of higher costs, we were able to generate $48 million of operating cash flow, $50.3 million of adjusted EBITDA and reduced our bank debt by $26 million. As of December 31, 2021, our bank debt was $111.7 million, bringing our liquidity to $35.9 million and our leverage ratio to 2.34x, within our covenant of 3x.

Turning our attention to 2022. We anticipate producing and selling 7 million tons. Our production volumes have increased, but it's still not at the 7 million ton pace. So we expect more shipments in the back half of '22 than in the first half. Our average sales price is 30% higher than 2021, and we expect those now to average roughly $31 a ton for the total full year 2022. So we expect slightly better margins on more tons in 2022. CapEx for our coal operations is expected to be $25 million in 2022.

Our big news was recently made public on February 15. Hallador announced its new wholly-owned subsidiary. Hallador Power Company will acquire Hoosier Energy's 1-gigawatt Merom Generation Station, located in Sullivan County, Indiana, in returned for assuming certain decommissioning costs and environmental responsibility.

The transaction, which includes a 3.5-year power purchase agreement, is scheduled to close mid-July upon obtaining required government and financial approval.

We expect Hallador Power to contribute little to Hallador's profit in 2022 as the plant is still limited, meaning it doesn't have enough fuel to procure to run very many hours in 2022.

However, this acquisition is significant starting next year as we begin to have additional fuel to put to the plant. At which time, we believe Hallador Power will begin to double Hallador Energy's adjusted EBITDA.

Additionally, at the end of the plant's useful life, Hallador and Hoosier expect to finalize the PPA to allow for renewable energy development appetite.

This transaction makes Hallador very unique and is an example of how Hallador help its customers transition to renewables, providing critical capacity to them in the near term, to maintain grid reliability, while creating a path to renewables through a PPA in the future.

We are working to increase our liquidity to allow for increased working capital and enable forward power sales. As such, on March 25, we executed an amendment to our credit facility to maintain our leverage covenant at 3x. We anticipate adding more liquidity to our balance sheet prior to our anticipated acquisition of Merom in mid-July.

All of these actions are setting up 2023 and beyond to be very special for Hallador. First, of the 5.3 million tons we have sold outside parties in 2023, our average sales price is $3.29 per ton higher than in 2022. Additionally, we have 2 million tons of coal beyond the 5.3 million to sell to the Merom power plant. This removes the fuel limitation of Merom.

Additionally, Russia's evasion of Ukraine has fundamentally changed the world's focus on energy independence and procuring Btus for the next few decades from supply other than Russia. With all forms of energy experiencing much higher prices, power prices are higher as well, and we have a large open position of both power plant capacity and energy starting from June of 2023. As we have previously stated, we believe this puts Hallador in a position to more than double its adjusted EBITDA in 2023 and beyond.

Maintenance CapEx for Hallador Power in 2023 is expected to be $16 million. In order to run the plant past 2025, we will be required to spend some money on environmental controls. We are currently evaluating how best to meet those requirements.

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In summary, Hallador Energy is becoming a fundamentally larger company. Our wholly-owned subsidiary, Sunrise Coal, will increase its production by over 20% going forward. And our new wholly-owned Hallador Power subsidiary will generate adjusted EBITDA equal to or greater than Sunrise Coal. All of this points to a very bright and lasting future for our shareholders.
With that, I'll open the mic up for questions.

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Question and Answer

Operator

[Operator Instructions] Our first question comes from Lucas Pipes from B. Riley Securities.

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

My first question is on the proposed transaction. And I just want to make sure I understand what happens after this initial 3.5-year term. Is that when the power plant is retired? Or is that when you would switch to -- or would you be able to extend the operating life of the coal plant beyond those 3.5 years?

Brent K. Bilsland
President, CEO & Chairman

Yes. So we're contracted with Hoosier to sell all of the capacity and energy through May of '23, and then a step down starting in June of '23 through December of '25 to roughly 30% of the capacity and 20-some-percent -- low 20% of the energy. We do not have to do any environmental upgrades to the plant to run through 2025.

If we extend beyond that, we'll have to spend some money on ELGs. We're still evaluating what's the best way to comply with that. What those cost structures are. We'll pull the trigger on that decision sometime next year. At current market prices, we think it absolutely makes sense to make those investments. But we will evaluate all that over the coming 12 months.

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

Okay. And if you make those investments, what would be the operating life of the plant?

Brent K. Bilsland
President, CEO & Chairman

That's largely based on economics. Right now, the markets are -- there's just not -- simply is not enough capacity, rated capacity to really keep the lights on. I mean I think the grid operator, if you read what MISO was saying, the reserve margins have come down significantly. They declared a state of emergency in MISO January 1, 2, 3. They have publicly stated they think that their grid could reach 80% renewables by 2050.

I don't think anybody really knows how long this transition takes. I think MISO is saying it's going to take longer than what the headlines are saying.

The market will determine how long it needs the capacity from our plant, but we have seen strong demand for our excess capacity since announcing this transaction in mid-February. And we have one supplier calling in 4 hours of announcement saying, I'll take all the capacity you have.

So the issue is all the utilities -- all public utilities especially want to transition, but they all have the same game plan, and you can't shut down generation that's rated -- has a rated capacity of, say, 92% of main play and replace that with generation that has a rated capacity of say, 25%.

To do that, you have to overbuild the lower rated capacity and you have to build an enormous amount of transmission lines. How long does that take? MISO's transmission projects typically take about a decade from planning to the permit meeting issue, and then they have to be built.

So I think FERC is doing some pace to try to be that up, but we've yet to see how long that transition will last. So how long will this plant last? Clearly, it's going to be determined by the market. We don't know the answer to that.

It looks, from supply vantage point, like it's got a long life ahead of it. But markets change every day. And so I'm confident the economics takes us to 2025. And we are studying what our environmental costs would be to extend the life of the plant beyond that. But we're optimistic.

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

Okay. That's helpful. And then in terms of your balance sheet, so on my numbers, it appears that you wouldn't generate sufficient free cash flow between now and maturity to essentially just pay this off out of cash. So could you share with me kind of how you think about refinancing opportunities? What sort of options you're considering here at this time?

Brent K. Bilsland
President, CEO & Chairman

Yes. So what we're looking at is -- so we say closing is subject to permit transfers and financial approvals. So we have to give permission from our bank group to allow Hallador Power [to pass] the Merom plant into our collateral position.

At the same point in time, our credit facility goes current towards the end of this year. And we want to increase our liquidity so that as we take on more working capital. And we want to make sure we have enough liquidity that we can -- if the market gives us the right opportunities to hedge the valuation that we think is appropriate, that we can put up the LCs to take advantage of those opportunities.

So power prices keep rising. Again, energy prices are up, right? I mean, I don't it's any secret that the world changed when Russia invaded Ukraine. I mean China -- Russia is the world's largest gas exporter. I think they're the #2 oil exporter in the world, and they're the #3 coal exporter in the world, where coal exports equal roughly 1/3 of U.S. coal production.

And suddenly, 80% of the world says, we can't touch Russian coal. So Europe now is looking to United States that has dramatically increased pricing, which is pushing up power pricing here as well because the power market has to decide do those Btus go overseas or do they stay home?

The advantage that we now have is Hallador has the choice. Do we want to put tons to the plant and generate electrons, or do we want to sell those tons elsewhere? So that is something we'll continue to evaluate.

At this time, we think it still makes sense even though coal prices are much higher. We still think it makes sense to put coal to the plant and generate electrons, we feel it's more profitable, but we have some obligations as well. So those are the things that we're evaluating.

We think it just puts us in such a unique position to be able to decide where the best place is to put our tons for the return of the Hallador shareholders.

So we're ecstatic about what we see. Like I said, the company is becoming bigger, both on the coal side and now with Hallador Power. And this is going to have a tremendous effect on our share price in the coming years.

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

And so the way to think about the maturity is that this is being renegotiated here as part of this transaction?

Brent K. Bilsland
President, CEO & Chairman

Correct. It is being renegotiated. With our term extension, we're looking for increased liquidity and to allow it as a collateral package, those conversations are ongoing now. But we feel good about it.

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

That's very helpful. And then my last question. We've -- I mean, we all know and feel the inflationary pressures. What's your guidance for cash costs? I may have missed it, but how do you think about the cost pressures affecting your operations?

Brent K. Bilsland
President, CEO & Chairman

Yes. We're all seeing inflationary pressures and supply pressures. I mean you have to fight right now to get inputs, such as glue and parts is very thin. I think all our suppliers are stretched towards the upper end of their limits as well.

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How long that lasts? I think it's -- everything you read says that this will dissipate throughout the year. Interest rates are rising. Fuel prices, electricity prices, food prices are all higher. That will have a slowing effect on the economy at some point in time.

I think what we see is -- for this year, we're showing an increase in our cost structure. We said we thought we would average $31 a ton of those out for the year. So again, we've added people. Our productivity is coming up. It hasn't come up as fast as we would like, but we're seeing gains every day. We're seeing light at the end of the tunnel.

We're getting -- we're spending a lot of time and effort to take a mine from 5, 5.5 units of production to 7, right? It takes the time to get set up, get everybody in the right location, get people hired, get people trained. But that's happening. That is happening.

So costs were great in the fourth quarter. I appreciate everybody's patience on that. I mean, we think we are absolutely headed in the right direction. And the potential of what we see coming, this year should be better than the last. 2023 and '24 and '25, for that matter, we think are just fantastic.

So when we look at the type of cash flow that we think will be coming out of a company today that has a market cap of somewhere north of $100 million, I think that -- I think the return on investment for the shareholder has the potential to be outstanding.

Operator

[Operator Instructions] We have no further questions. I'll now hand back to Brent Bilsland for closing remarks.

Brent K. Bilsland
President, CEO & Chairman

Yes. I appreciate everyone's time today and interest in the company. Again, I just want to reiterate how excited we are about what we see coming around the corner and the opportunities in front of us. And we thank you for your continued interest. Thank you.

Operator
This concludes today's call. We'd like to thank you for your participation. You may now disconnect your lines.

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